SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

CORONADO OIL AND GAS COMPANY

WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

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[Caption omitted.]

Before United States Board of Tax Appeals

Docket No. 10503

CORONADO OIL AND GAS COMPANY, CLEVELAND, OKLA.

v.

COMMISSIONER OF INT. REV.

For Taxpayer: H. L. Bolen, Esq., S. M. Hayes, Esq., T. P. Gore, Esq., D. A. Richardson, Esq.
For Commissioner: Max E McDowell, Esq., W. F. Gibbs, Esq., D. H. Green, Esq.
Mr, Green (Member) transferred to Mr. Trussell 10-26-28.

Docket entries

1925
Dec. 31. Petition received and filed.

1926
Jan. 8. Copy of petition served on solicitor.
" 8. Notification of receipt mailed taxpayer.
" 28. Answer filed by solicitor.
Feb. 3. Copy of answer served on taxpayer—assigned to field cal.
Dec. 17. Motion for leave to file amended petition filed, amendment tendered.
" 18. Hearing set for 2-8-27 at Oklahoma City.
" 21. Granted. Both sides notified.
" 22. Copy of motion and amended petition served on G. C.

2 1927
Mar. 22. Transcript of hearing 2-3-27 filed.
Apr. 12. Motion for an extension to 5-4-27 to file brief, filed by taxpayer.
" 12. Brief filed by general counsel.
" 13. Granted. Both sides notified.
Sept. 7. Ordered case be restored to trial cal. for argument at a time agreed upon—signed and filed. Both sides notified. See 3707.
Nov. 12. Brief filed by taxpayer.
" 29. Hearing had before Mr. Green on merits. Submitted.
Dec. 5. Transcript of hearing 11-29-27 filed.

1929

Jan. 14. Findings of fact and opinion rendered. Mr. Trussell. Judgment under rule 50.
Mar. 25. Notice of settlement filed by G. C.
" 28. Hearing set 4-23-29.
Apr. 20. Motion for continuance to 5-13-29 filed by taxpayer. 4-23-29 Granted.
" 23. Hearing had before Mr. Phillips on settlement under rule 50; by consent continued 5-13-29.
May 13. Hearing held before Mr. Arundell on settlement under rule 50; not contested, assigned Mr. Trussell for order.
" 14. Decision entered, Summer L. Trussell, div. 6.
Oct. 30. Stipulation of venue filed—Ct. of Appeals, D. C.
" 30. Petition for review by Ct. of Ap. D. C. with assignments of error filed by taxpayer.
" 30. Proof of service filed.
Nov. 19. Statement of evidence lodged.
" 19. Notice of lodgment of statement of evidence with hearing set 11-30-29.
" 30. Order continuing to day cal. of Dec. 4, 1929, entered.
Dec. 5. Agreed statement of evidence approved and ordered filed.
" 5. Agreed praecipe filed.
" 5. Proof of service of agreed praecipe filed.

3 Now, December 9, 1929, the foregoing docket entries certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. Gamble,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503

APPEAL OF CORONADO OIL & GAS COMPANY, CLEVELAND, OKLAHOMA

Petition

Filed Dec. 31, 1925

The above named taxpayer appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:CA-2558-1-60D) dated November 13, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is an Oklahoma corporation with principal offices at Cleveland, Oklahoma.

2. The deficiency letter (a copy of which is attached hereto), is dated November 31, 1925, the date of mailing to the taxpayer being unknown.

3. The taxes in controversy are income and profits taxes for the calendar years 1917, 1918, and 1919 and are more than $10,000.00, viz:

	Amount
1917	$ [illegible]
1918	3,398.60
1919	2,690.52

4. The determination of tax contained in said deficiency letter is based upon the following errors:

(a) The Commissioner of Internal Revenue did not include the difference between the par value of the capital stock and the market value of the assets received in exchange therefor, amounting to $55,800.00, as paid in surplus in determining the invested capital for the years 1917, 1918, and 1919.

(b) The Commissioner of Internal Revenue allowed depreciation at the rate of 10% per annum on the lease equipment, based on the cost of the equipment to the individuals who acquired same from the former lease owner, amounting to $55,800.00, instead of the market value of the equipment transferred to the corporation in exchange for its capital stock, bonds and note, amounting to $111,600.00, which resulted in an increase in the taxable income for the year 1917 amounting to $5,580.00, year 1918 $5,580.00, year 1919 $5,580.00.

(c) The Commissioner of Internal Revenue included in the taxable income for the calendar years 1917, 1918, and 1919 the amounts of $15,949.68, $22,413.94, and $13,500 [illegible]8, respectively, which amounts were income or profits the taxpayer derived from school land owned by the State of Oklahoma and leased for oil and gas purposes and are exempt from taxation by the United States.

5. The facts upon which the taxpayer relies as its basis of appeal are as follows:

(a) On January 9, 1914, G. W. Sutton, acting for himself, J. B. Myers, R. L. Lunsford, and John R. Williams, all of Cleveland, Oklahoma, made an application to the commissioners of the land office of the State of Oklahoma to lease for oil and gas purposes, under the laws of the State of Oklahoma, and the rules and regulations of the commissioners of the land office, the following described lands:

The S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, Oklahoma.

The rules and regulations of the commissioners of the land office governing the bidding on the lease on the above described lands provided for the payment of $55,800.00 by the successful bidder to the Southwestern Oil Fields Company, former lessee, for the equipment on the lease.

G. W. Sutton was the successful bidder and the commissioners of the land office at a meeting held on January 19, 1914, authorized and directed the chairman and secretary to enter into a lease contract

with G. W. Sutton for a term of five years and to fix his bond at $10,000.00.

After possession of the lease and improvements had been delivered to Mr. Sutton the amount of $55,800.00, deposited by him with the commissioners of the land office, was paid over to the Southwestern Oil Fields Company for the improvements on the lease.

At the request of G. W. Sutton the lease awarded him on the above described lands was made to the Coronado Oil and Gas Company.

The considerations received by the four individuals mentioned above, in exchange for this lease made by the State of Oklahoma to the Coronado Oil and Gas Company consisted of the following items:

Bonds of the corporation in the amount of $25,000.00.

Note of the corporation in the amount of $5,800.00.

Capital stock of the corporation of the par value of $25,000.00.

However, the capital stock of the corporation had a fair market value of $80,800.00 at the time of issue, which value was based on the fair market value of the equipment on the lease exchanged therefor, which amounted to $111,600.00 at the time of the exchange.

This valuation of $111,600.00 on the equipment was made in good faith by the above mentioned four individuals and this amount was entered in the "equipment account" on the books of the corporation as the cost of the equipment.

The amount of $55,800.00 representing the excess of the cost of the equipment over the total of the par value of the stock and the bonds issued, and the face value of the note executed, was credited to the paid up surplus account, thus placing the value of $80,800.00 on the capital stock issued at the date of issue.

(b) Under the provisions of the enabling act approved June 16, 1906, upon admission of the State of Oklahoma to the Union, sections 16 and 36 in every township in Oklahoma Territory and all indemnity lands theretofore selected in lieu thereof were granted to the State of Oklahoma for the use and benefit of the common schools.

The enabling act further provided that such sections 16 and 36 and the lands taken in lieu thereof which were granted for the
6 support of the common schools, if sold, should be appraised and sold at public sale. The proceeds were to constitute a permanent school fund, interest on which only should be expended in support of such schools. But said lands might, under such regulations as the legislature prescribed, be leased for a period not to exceed ten years and such lands should be reserved for school purposes only.

However, the above provisions were subjected to the following limitations:

Where any part of the lands granted by this act to the State of Oklahoma were valuable for minerals, gas or oil, such lands should not be sold by the said State prior to January 1, 1915, but the same

might be leased for a period not to exceed five years by the State officers duly authorized for that purpose, and all proceeds from leases should be covered to the fund to which they should properly belong and no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper State authorities in writing.

Section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, was included in the lands granted to the State of Oklahoma under the provision of the enabling act as set forth above, and the part of said section 16 included in the lease from the State of Oklahoma to the taxpayer was still owned and held by the State for the use and benefit of the common schools during the years 1917, 1918, and 1919.

The lease for oil and gas purposes on the S. ½ of the N. W. ¼; S. W. ¼, N. E. ¼, S. ½ of the S. E. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, between the taxpayer and the State of Oklahoma was made in accordance with the terms and conditions of the enabling act and the statutes of the State of Oklahoma.

The State of Oklahoma through its school land commissioners employed the taxpayer to develop the leased premises for oil and gas. The lease specified a fixed royalty determined, as the law provided, by the commissioners of the land office and stipulated that the

lessee should have and receive the balance of any production
7 as compensation for its risk, services and outlay in connection with such development and operations.

The taxpayer executed to the State, as required by law, a good and sufficient bond for the faithful performance of such lease. The lease was subject to forfeiture for breach of conditions, and could not be assigned or transferred without the consent in writing of the commissioners of the land office.

(c) The total net income or profits of the taxpayer for the calendar years 1917, 1918, and 1919 was derived from the sale or disposition of its share of the oil and gas received under its lease on the S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma.

The taxpayer had no income from any source other than the lease on the above described lands during the years 1917, 1918, and 1919.

The amount of the net income of the taxpayer from this lease, as determined by the Commissioner of Internal Revenue and set forth in his deficiency letter dated November 13, 1925, for each of the years in question was as follows:

Year	Amount
1917	$15,949.69
1918	22,413.94
1919	13,500.88

6. The taxpayer, in support of its appeal, relies upon the following propositions of law:

(a) That as used in this title the term "invested capital" for any year means the actual cash value of tangible property, other than the cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus.

(b) That in computing the net income there shall be allowed
8 as deductions: in the case of mining, oil, gas leases and other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted.

(c) When the source of the income is exempt from taxation the income itself is exempt from taxation. School land owned by a sovereign State is not subject to taxation by the United States.

Income and profits derived from such tax exempt school lands under an oil and gas mining lease are not subject to tax by the United States.

Wherefore the taxpayer respectfully prays that this board may hear and determine its appeal.

HUBERT L. BOLEN,
HUBERT L. BOLEN,
Counsel for Taxpayer.
621 Tradesmens Natl. Bank Bldg.,
Oklahoma City, Oklahoma.

[*Duly sworn to by R. L. Lunsford; jurat omitted in printing.*]

8-A Copy

STATEMENT

IT: CA: 2558-1-60-D.

In re: Coronado Oil and Gas Company, Cleveland, Oklahoma.

Years examined	Deficiency in tax
1917 (waiver expires 12-31-25)	$6,152.76
1918 (waiver expires 12-31-25)	8,398.60
1919 (waiver expires 12-31-25)	2,690.42
Total	17,241.78

Year ended December 31, 1917

SCHEDULE #1

Net income:	
Net income as disclosed by books as shown by agent's report dated April 22, 1922	$16,209.76
As corrected	15,949.69
Net deductions	260.07

Deductions:		
a. Additional depletion allowable	$260.07	
Total deductions		260.07
Net deductions as above		260.07

Explanation of items changed

a. Depletion allowed by revenue agent	$399.34
b. Depletion allowable	659.41
Additional depletion allowable	260.07

Depletion is computed for this year on the capitalized cost of drilling in the amount of $5,127.27, and estimated recoverable reserves at beginning of the year of 224,630 barrels, and a production of 28,896 barrels, or a unit of cost of $0.02282.

SCHEDULE #2

Invested capital

Invested capital disclosed by books. Agent's report dated April 22, 1922		$35,142.56
As corrected		25,000.00
Net reductions, as explained below		142.56
Reductions:		
8. Earned surplus reduced by operating deficit, as shown by adjusted balance sheet	$142.56	
Total reductions as above		142.56

SCHEDULE #3

Computation of tax, 1917 act

Excess profits tax

Corporation:	
Net income taxable year, (Schedule 1)	$15,949.69
Net income subject to excess profits tax	15,949.69
Invested capital (Schedule 2)	25,000.00
Variable deduction, 8%	2,000.00
Specific exemption	3,000.00
Total deduction	5,000.00

	Income	Deductions	Balance	Rate	Tax
15%	$3,750.00	$3,750.00		20%	
5%	1,250.00	1,250.00		25%	
5%	1,250.00		$1,250.00	35%	$437.50
5%	2,000.00		2,000.00	45%	900.00
Balance	7,699.69		7,699.69	60%	4,619.81
Totals	15,949.69	5,000.00			5,957.31

SCHEDULE #4

Computation of tax, 1917

Total tax

		Tax
Taxable net income (Schedule 1)	$15,949.69	
Deduct:		
Excess-profits tax (Schedule #3)	5,957.31	$5,957.31
Taxable at 2%	9,992.38	199.85
Taxable at 4%	9,992.38	399.70
Total tax liability		6,556.86
Previously assessed		404.10
Deficiency in tax		6,152.76

Year ended December 31, 1918

SCHEDULE #1

Net income:	
Net income as disclosed by books, as shown by revenue agent's report dated April 22, 1921	$22,715.34
As corrected	22,413.94
Net deductions	301.40
Deductions:	
a. Additional depletion allowable	301.40
Total deductions	301.40

Explanation of items

a. Depletion allowed by revenue agent	$462.80
b. Depletion allowable	764.20
Additional depletion allowable	301.40

Depletion is computed for this year on the capitalized cost of drilling in the amount of $4,467.96 as at the beginning of the year and estimated recoverable reserves at the beginning of the year 195,734 barrels, and a production of 33,488 barrels, or a unit cost of $.02282.

SCHEDULE # 2

Invested capital

Invested capital disclosed by books, as shown by agent's report dated April 22, 1921		$37,313.40
As corrected		36,107.03
Net reductions as explained below		1,206.37
Additions:		
a. Difference in prorating 1917 income tax	$130.62	
Total additions		130.62
Deductions:		
b. Dividend paid November 4, 1918, prorated	1,336.99	
		1,336.99
Net reductions as above		1,206.37

Explanation of items changed

a. Difference in prorating corrected income and excess profits taxes.
b. Dividend of $20,000.00 paid November 4, 1918, prorated out of invested capital, after applying thereto the available earnings to date of payment less tentative tax.

SCHEDULE # 3

War profits credits, 1918 act

Adjusted invested capital taxable year (Schedule 2)	$36,107.06
Average adjusted prewar capital	None.
Average net income prewar period	None.
10% of invested capital	3,610.70
Exemption	3,000.00
War profits credit	6,610.70

SCHEDULE # 4

Computation of tax, 1918 rates

Excess profits tax

Net income (Schedule 1)	$22,413.94
Invested capital (Schedule 2)	36,107.06
8% of invested capital	2,888.56
Exemption	3,000.00
	5,888.56

Computation of tax under section 301

	Income	Credit	Taxable	Rate	Tax
30%	$7,221.41	$5,888.56	$1,332.85	30%	$399.86
Balance	15,192.53		15,192.53	65%	9,875.14
Total	22,413.94				10,275.00

War profits tax

Net income (Schedule 1)	$22,413.94	
Less credit (Schedule 3)	6,610.70	
Taxable at 80%	15,803.24	$12,642.59
Less: Excess profits tax		10,275.00
War profits tax		2,367.59
Profits tax computed under section 301		12,642.59

Computation of tax under section 302

		Rate	Tax
Income up to $20,000.00; credit $3,000.00; taxable	$17,000.00	30%	$5,100.00
Balance $2,413.94	2,413.94	80%	1,931.15
Profits tax under section 302			7,031.15

Income tax

Net income taxable year	$22,413.94	
Less:		
War profits tax and excess profits tax	7,031.15	
Exemption	2,000.00	
Total	9,031.15	
Balance taxable at 12%	13,382.79	
Income tax		$1,605.93
Total profits and income tax		8,637.08
Previously assessed		238.48
Deficiency in tax		8,398.60

Year ended December 31, 1919

SCHEDULE No. 1

Net income:		
Net income as disclosed by books as shown by revenue agent's report dated April 22, 1921		$14,066.77
As corrected		13,500.88
Net deductions		565.89
Deductions:		
a. Additional depletion allowable	$565.89	
Total deductions		565.89

Explanation of items changed

a. Depletion allowed by revenue agent	685.40
b. Depletion allowable	1,251.29
	565.89

Depletion is computed for this year on the cost of lessees capitalized cost of drilling in the amount of $11,584.81, and estimated recoverable reserves at the beginning of the year of 162,246 barrels, and a production of 17,525 barrels, or a unit cost of $.0714.

SCHEDULE No. 2

Invested capital

Invested capital disclosed by books as shown by revenue agent's report dated April 21, 1921		$33,229.61
As corrected		39,664.43
Net additions as explained below		6,434.82
Additions:		
a. Reserve for Federal income and excess-profits taxes	$6,329.86	
b. Differences in prorating 1918 Federal income and excess profits taxes	104.96	
Total additions		6,434.82
Net additions as above		6,434.82

Explanation of items changed

a. Invested capital has been increased by the reserve for Federal income and excess profits taxes, as shown on the adjusted balanced sheets prepared by the revenue agent.

b. Difference in prorating corrected 1918 Federal income and excess-profits taxes of $8,637.08.

SCHEDULE No. 3

Computation of tax, 1919 rates

Excess profits tax

Net income, Schedule 1	$13,500.88
Invested capital, Schedule 2	39,664.43
8% of invested capital	3,173.15
Plus exemption	3,000.00
Total credit	6,173.15

% of capital	Income	Credit	Taxable	Rate	Tax
20%	$7,932.89	$6,173.15	$1,759.74	20%	$351.95
Balance	5,567.99		5,567.99	40%	2,227.20
Total	13,500.88	6,175.15	7,327.73		2,579.15

Tax computed under section 302

Net income	$13,500.88	
Less exemption	3,000.00	
Balance subject to tax at 20 per cent	10,500.88	$2,100.18

Income tax

Net income taxable year	13,500.88	
Less:		
Profits tax	2,100.18	
Exemption	2,000.00	
Balance taxable at 10 per cent	9,400.70	
Income tax		940.07
Total income and excess-profits tax		3,040.25
Previously assessed		349.83
Deficiency in tax		2,690.42

In arriving at the above adjustments your protests and all the evidence submitted have been carefully considered.

The bureau has ruled that inasmuch as you acquired your properties for stock, bonds, and a note, that you are entitled to set up as the value of the assets acquired, the then actual cash value as of the date of the transaction. The State appraised your properties at $55,800 and the selling of them to Mr. Sutton for this figure a few days before you acquired them is considered the best evidence available as to the value of the assets when acquired by you. Therefore, your claim for paid-in surplus is denied.

Further, inasmuch as it appears that you are the original lessee, no paid-in surplus may be allowed with respect to your lease. (See page 288, A. R. R. 86, Cumulative Bulletin #2.)

You are also advised that the bureau has consistently held that the income or profits accruing to a lessee derived from the production of oil and gas from school lands owned by the State of Oklahoma is not exempt from Federal income tax.

Payment of the deficiency in tax should not be made until a bill is received from the collector of internal revenue for your district and remittance should then be made to him.

Now, December 9, 1929, the foregoing petition certified from the record as a true copy.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

9

Copy

Form NP-2

Treasury Department, Washington

Refer to IT:CA:2558-1-60-D.

Nov. 13, 1925.

CORONADO OIL AND GAS COMPANY,
Cleveland, Oklahoma.

SIRS: The determination of your income tax liability for the years 1917, 1918, and 1919, pursuant to an examination of your books of account and records, as set forth in bureau letter dated December 23, 1922, disclosed a deficiency in tax aggregating $17,241.78, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CA:2558-1-60-D. In the event that you acquiesce in a

part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner.

(Signed) By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statements. Agreement—Form A.

(Here follow pages Nos. 12, 13, 14, 15, 16, 17, 18, and 19.)

10 Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Jan. 28, 1926

Now comes the Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, and for answer to the petition of this taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraphs 1, 2, and 3 of the taxpayer's petition.

(2) Denies that the commissioner erred in disallowing $55,800.00, alleged paid-in surplus claimed by the taxpayer for the purpose of computing invested capital for the years 1917, 1918, and 1919.

(3) Denies that the commissioner erred in allowing depreciation on lease equipment based only on a valuation of such assets amounting to $55,800.00.

(4) Denies that the commissioner erred in including in taxable income for the calendar years 1917, 1918, and 1919 the amounts of $15,949.68, $22,413.94, and $13,500.88, respectively, which amounts represent income of this taxpayer.

(5) Denies the material allegations of fact contained in paragraph 5 of the taxpayer's petition.

(6) Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Propositions of law

(1) The commissioner properly excluded from invested capital of this taxpayer $55,800.00, alleged by the taxpayer to constitute paid-in surplus.

(2) In the case of oil and gas leases, there shall be allowed as deductions in computing net income, a reasonable allowance
11 for depletion and for depreciation of improvements, according to the peculiar conditions in each case based upon cost, including cost of development, not otherwise deducted.

(3) Income derived by a lessee through the exploitation of oil wells located on school land owned by the State of Oklahoma is

subject to the income tax imposed by the revenue acts of 1917 and 1918.

Wherefore it is prayed that this taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:

THOMAS M. WILKINS,
Special Attorney, Bureau of Internal Revenue.

Now, December 9, 1919, the foregoing answer certified from the record as a true copy.

[Seal United States Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Amended petition

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice (IT:CA-2658-1-60 D) dated November 13, 1925, and as a basis of its proceeding, alleges as follows:

(1) The petitioner is a corporation, organized and existing under the provisions of the laws of the State of Oklahoma, with its principal office at Cleveland, Oklahoma.

12 (2) The notice of deficiency (a copy of which is attached and marked Exhibit A) is dated November 13, 1925, the date of mailing to the petitioner being unknown.

(3) The taxes in controversy are income and profits taxes for the calendar years 1917, 1918, and 1919 and are approximately $18,234.19 as shown below:

Year	Amount
1917	$6,566.86
1918	8,627.08
1919	3,040.25
Total	18,234.19

(4) The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erroneously included in the taxable net income of the petitioner for the calendar years 1917, 1918, and 1919, the amounts of $15,949.69, $22,413.94, and $18,500.88, respectively. The entire net income or profit of the petitioner for the calendar years 1917, 1918, and 1919, which the Commissioner of Internal Revenue has determined to be the amounts stated above, was the income or profit derived by the petitioner from

school land owned by the State of Oklahoma and leased by the petitioner from the State of Oklahoma for oil and gas purposes and as such is exempt from taxation by the United States.

(b) In computing the invested capital of the petitioner for the calendar years 1917, 1918, and 1919, the Commissioner of Internal Revenue did not include therein the paid-in surplus amounting to $58,538.00. This paid-in surplus is represented by the fair market value of the development on an oil and gas lease which amounted to $58,538.00 on the date the lease was acquired. This development of the value stated above and the physical equipment on this lease, the value of which is admitted by the Commissioner of Internal Revenue to be $55,800.00, was acquired by the petitioner in exchange for its capital stock of the par value of $25,000.00, bonds of the petitioner of the face value of $25,000.00 and the note of the petitioner for the amount of $5,800.00.

13 (c) In computing the invested capital of the petitioner for the calendar year 1918 the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $3,559.22 as an adjustment for the 1917 tax prorated. If the income from this source is held to be taxable the correct amount to be deducted is $608.66 or a difference of $2,950.56.

(d) In computing the invested capital of the petitioner for the calendar year 1918, the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $1,336.99 as an adjustment for the amount of a dividend paid November 4, 1918 out of capital prorated. The Commissioner of Internal Revenue erroneously deducted the amount of a tentative tax from the available earnings to the date of the dividend payment and applied only the remainder of such earnings to the amount of the dividend paid. The correct amount to be deducted is $648.05 or a difference of $688.94.

(c) In computing the invested capital of the petitioner for the calendar year 1919, the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $3,650.05 as an adjustment for the 1918 taxes prorated. If the income from this source is held to be taxable, the correct amount to be deducted is $2,612.04 or a difference of $1,038.01.

(f) The amount of tax assessed (and paid) by the petitioner for the calendar year 1918 is understated by the Commissioner of Internal Revenue in the deduction from the total tax determined, to arrive at the amount of the deficiency shown in the deficiency notice. The amount of the tax paid by the petitioner for the year 1918 was $311.09, no part of which has been refunded. The amount of tax assessed and deducted from the total tax determined as shown by the deficiency notice was $238.48, an understatement of $72.61.

(g) The amount of the Federal income tax for the calendar year 1918, which was paid during the year 1919, was overstated in the revenue agent's report in his computation of the net taxable income

of the petitioner for the calendar year 1919 by the amount of $178.50. The revenue agent disallowed as a deduction the amount of $489.59 as Federal income tax for the year 1918 paid during
14 the year 1919. The total amount of tax paid for the year 1918 during the year 1919 was $311.09. This overstatement of the unallowable deduction resulted in an overstatement of the net taxable income for the year 1919 in the revenue agent's report. This error in the amount of the taxable net income was not corrected by the Commissioner of Internal Revenue in his determination of the deficiency.

(h) The amount of depletion allowed as a deduction by the Commissioner of Internal Revenue for the calendar years 1917, 1918, and 1919 was erroneously computed on the basis of the cost of the development of the lease subsequent to the acquisition of the same by the petitioner. The fair market value of the development on the lease, amounting to $8,538.00 when acquired, was a part of the assets received in exchange for the capital stock, bonds and note of the petitioner and is subject to depletion. No depletion on the cost of this development has been allowed by the Commissioner of Internal Revenue. The amounts of depletion sustained and allowable as a deduction during the calendar years 1917, 1918, and 1919, as shown by a Form "O" and engineers appraisal report on the property operated, exceeds the amounts allowable by the Commissioner of Internal Revenue as shown below:

Year	Amounts allowed by commissioner	Amounts sustained	Excess
1917	$659.41	$4,789.68	$4,130.27
1918	764.20	4,394.67	3,630.47
1919	1,251.29	6,169.62	4,918.33
Total	2,674.90	15,353.97	12,679.07

(5) The facts upon which the petitioner relies as the basis for this proceeding are as follows:

(a–1) Under the provisions of the enabling act approved June 16, 1906, upon admission of the State of Oklahoma to the Union, sections 16 and 36 in every township in Oklahoma Territory and all idemnity lands theretofore selected in lieu thereof were granted to the State of Oklahoma for the use and benefit of the common schools.

(a–2) The enabling act further provided that such sections
15 16 and 36 and the lands taken in lieu thereof which were granted for the support of the common schools, if sold, should be appraised and sold at public sale. The proceeds were to constitute a permanent school fund, interest on which only should be expended in support of such schools. But said lands might, under such regulations as the legislature prescribed, be leased for a period not to exceed ten years and such lands should be reserved for school purposes only.

(a–3) However, the above provisions were subject to the following limitations:

Where any part of the lands granted by this act to the State of Oklahoma were valuable for minerals, gas or oil, such lands should not be sold by the said State prior to January 1, 1915, but the same might be leased for a period not to exceed five years by the State officers duly authorized for that purpose, and all proceeds from leases should be covered to the fund to which they should properly belong and no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper authorities in writing.

(a–4) Section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, was included in the lands granted to the State of Oklahoma under the provision of the enabling act as set forth above, and the part of said section 16 included in the lease from the State of Oklahoma to the petitioner was still owned and held by the State for the use and benefit of the common schools during the years 1917, 1918, and 1919.

(a–5) The lease for oil and gas purposes on the S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, between the petitioner and the State of Oklahoma was made in accordance with the terms and conditions of the enabling act and the statutes of the State of Oklahoma.

(a–6) The State of Oklahoma through its school land commissioners employed the petitioner to develop the leased premises for oil and gas. The lease specified a fixed royalty determined, as the law provided, by the commissioners of the land office and stipulated that the lessee should have and receive the balance of any production as compensation for its risk, services, and outlay in connection with such development and operations.

16 (a–7) The petitioner executed to the State, as required by law, a good and sufficient bond for the faithful performance of such lease. The lease was subject to forfeiture for breach of conditions, and could not be assigned or transferred without the consent in writing of the commissioners of the land office.

(a–8) The total net income or profits of the petitioner for the calendar years 1917, 1918, and 1919 was derived from the sale or disposition of its share of the oil and gas received under its lease on the S. ½ of the NW. ¼; SW. ¼ NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma.

(a–9) The petitioner had not income from any source other than the lease on the above described lands during the years 1917, 1918, and 1919.

(a–10) The amount of the net income of the petitioner from this lease, as determined by the Commissioner of Internal Revenue and

set forth in his deficiency letter dated November 13, 1925, for each of the years in question was as follows:

Year	Amount
1917	$15,949.09
1918	22,413.94
1919	13,500.88

(b–1) For several years prior to January 17, 1914, the Southwestern Oil Fields Company held an oil and gas lease on certain school lands belonging to the State of Oklahoma and described as follows:

Northeast quarter, south half of the northwest quarter, the southwest quarter and the south half of the southeast quarter, all in section 16, township 21 north, range 8 east of the Indian meridian, containing 480 acres.

This lease was a term lease and was to expire January 17, 1914. Under the terms of the lease the lessee had the preference right to release the property at the highest and best bid received for the next term of five years. The lease also provided that the physical equipment placed on the lease by the lessee and used in the operation thereon should be appraised at its fair market value by
17 the State, such appraised value to be the sales price of such equipment to the successful bidder in case the lessee failed to exercise its preference right to release the property. The terms of the lease provided that no expense incurred in drilling wells should be considered improvements or included in the appraised value thereof.

(b–2) At a meeting of the commissioners of the land office of the State of Oklahoma on September 18, 1913, Frank Orr was selected and designated on behalf of the State to appraise the improvements on the above described property.

(b–3) At a meeting the said commissioners of the land office on December 4, 1913, there was issued a notice of receiving bids for leasing the property described in paragraph (b–1) for oil and gas purposes. Among other things the notice of receiving bids provided as follows:

Said lands to be leased for oil and gas purposes is for a term of five years, with the preference right to release for an additional period of five years, at a royalty of 50% of the total output of all oil and gas from said lands and in addition there to such bonus as may be offered. All bids must be on forms provided and filed on January 9, 1914, and each bid must be accompanied by a certified check for $3,000.00 as earnest money. Each bidder shall deposit the sum of $55,800.00 in cash or bank draft drawn by some bank in the State of Oklahoma, payable to the commissioners of the land office of the State of Oklahoma for the improvements located on said land and now used in connection with the oil and gas wells being operated by the Southwestern Oil Fields Company, said improvements having been appraised and the value of same having been fixed in the above amount. Said sum of money so deposited

by the successful bidder to be paid over to said Southwestern Oil Fields Company in the event it elects not to exercise its preference right.

(b–4) In addition to the provisions set forth in the notice of receiving bids, the rules and regulations of the commissioners of the land office provided as follows:

The highest responsible bidder will be required to give bond
18 for the faithful performance of his contract and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay.

(b–5) On January 9, 1914, Geo. W. Sutton, acting for himself and three other individuals, namely, J. B. Myers, R. L. Lunsford, and John R. Williams, all of Cleveland, Oklahoma, filed a bid with the commissioners of the land office for the lease for oil and gas purposes on the land described in paragraph b–1 above. This bid was filed in answer to the notice of receiving bids mentioned above and offered to pay the royalty of 50% of all the oil and gas recovered with no bonus.

(b–6) On the same day the Southwestern Oil Fields Company filed a bid with the commissioners of the land office for the lease for oil and gas purposes on this same land offering to pay a royalty of 12½% of all the oil and gas recovered together with a cash bonus of $15,000.00. No other bids were filed.

(b–7) After considering the two bids received, at the meeting of the commissioners of the land office held January 12, 1914, it was moved and seconded that Geo. W. Sutton be declared the highest responsible bidder and that his bid be declared the highest and best bid received and that he be awarded a lease upon the above described land provided that if the Southwestern Oil Fields Company in the exercise of its preference right takes the lease at the high bid so received, then in that event a lease be awarded to said company for a second period of five years. The motion prevailed.

(b–8) At the meeting of the commissioners of the land office held January 19, 1914, the secretary reported that the Southwestern Oil Fields Company, in the exercise of their preference right, elected not to take a lease on the above described lands for the second period of five years upon the award recently made to Geo. W. Sutton. Thereupon, after possession of the lease and equipment had been delivered to Mr. Sutton, the amount of $55,800.00 deposited by him was paid over to the said Southwestern Oil Field Company. The chairman and secretary were authorized and directed to enter into a lease contract with Geo. W. Sutton for a term of five years and that his bond be fixed at $10,000.00, same to be a surety bond.

19 (b–9) At the meeting referred to in paragraph (b–8) above, after the officers had been directed to enter into the lease contract with him, the said Geo. W. Sutton requested that the lease awarded to him on the NE. ¼, S. ½ of NW. ¼, SW. ¼, and S. ½ of SE. ¼ be made to the Coronado Oil and Gas Company. After proper action this request was granted.

(b–10) On January 20, 1914, Geo. W. Sutton, J. B. Myers, and George Reynolds, all of Cleveland, Oklahoma, prepared and signed the articles of incorporation of the Coronado Oil & Gas Company. This document was forwarded to the secretary of state of Oklahoma and received by his office on January 21, 1914. On the same date the charter of the said Coronado Oil & Gas Company was issued.

(b–11) On or about February 2, 1914, the total authorized capital stock of the Coronado Oil & Gas Company, consisting of 250 shares, par value $100.00 each. Bonds of the par value of $25,000.00 and a note for the amount of $5,800.00 were issued by the corporation in full payment for the lease, the development on same and the equipment taken over from the Southwestern Oil Fields Company.

(b–12) The fair market value of the capital stock of the Coronado Oil and Gas Company at the time it was issued amounted to $83,538.00, which amount was determined as follows:

1. Fair market value of the equipment on the lease at the time same was acquired by the corporation, amounting to	$55,800.00
2. Fair market value of the development on the lease at the time same was acquired by the corporation, amounting to	58,538.00
Total	114,338.00
3. Deduct fair market value of bonds and note issued in part payment for assets	30,800.00
Fair market value of capital stock issued	83,538.00

(b–13) By a resolution passed by the commissioners of the
20 land office at a meeting held February 24, 1916, the expense of drilling wells on school lands was recognized as an additional value received by the successful bidder for a lease previously operated, and for this reason amended the rules and regulations, providing for an appraisal of the improvements on the lease, to include in the appraised value of such improvements, a fair, just, and reasonable compensation for the cost and expense of drilling each well then producing oil or gas in paying quantities and of each incompleted well on the lease at the time of such appraisal.

(b–14) On January 17, 1917, the petitioner and the commissioners of the land office entered into a supplemental agreement relative to the oil and gas lease on the land described in paragraph (b–1) above. This supplemental agreement provided that the royalty rate on all wells drilled on this property by the petitioner subsequent to this agreement should be 12½% of all the oil and gas produced therefrom instead of the 50% called for in the original lease.

(c–1) The revenue agent's report dated April 22, 1921, covering an examination of the books and records of the petitioner for the calendar years 1917, 1918, and 1919, on which the Commissioner of Internal Revenue bases his determination, shows the total tax assessable for the year 1917 to be the amount of $6,733.96. In adjusting the invested capital for the calendar year 1918, this amount was prorated for 200 days giving the adjusted average of $3,689.84. In schedule 2 for the year 1918 of the statement attached to the defi-

ciency notice the Commissioner of Internal Revenue increased the invested capital for the year 1918 as shown by the revenue agent's report by the amount of $130.62 with the explanation of "Difference in prorating 1917 income tax." This leaves the net amount deducted in the deficiency notice for 1917 taxes prorated amount to $3,559.22.

(c–2) If it is held that the income from this source is taxable then the correct amount of total tax assessable for the year 1917 is $1,110.81 which amount prorated for 200 days gives $608.66 for the adjusted average to be deducted from the invested capital as of the beginning of the year 1918.

(d–1) In computing the invested capital for the calendar year 1918 the Commissioner of Internal Revenue deducted
21 from the invested capital as shown by the revenue agent's report, the amount of $1,336.99 with the explanation "dividend paid November 4, 1918, prorated." A further explanation of this item was made in the 60-day letter which is as follows:

"Dividend of $20,000.00 paid November 4, 1918, prorated out of invested capital, after applying thereto the available earnings to date of payment less tentative tax."

(d–2) The correct amount to be deducted from the invested capital as of the beginning of the year for the dividend paid November 4, 1918, in excess of earnings available on that date is $648.05.

(d–3) The deduction of the amount of the tentative tax from the earning available for distribution is unwarranted under the law.

(e–1) The revenue agent's report, referred to in paragraph (c–1) above, shows the total tax assessable for the year 1918 to be the amount of $8,885.44. In adjusting the invested capital for the year 1919, this amount was prorated 154¼ days giving the adjusted average of $3,755.01. In schedule 2 for the year 1919 of the statement attached to the deficiency notice, the Commissioner of Internal Revenue increased the invested capital for the year 1919, as shown by the said revenue agent's report, by the amount of $104.96, with the explanation of "difference in prorating 1918 Federal income and excess-profits taxes." This leaves the net amount deducted in the deficiency notice for 1918 taxes prorated amount to $3,650.55.

(e–2) If it is held that this income is taxable then the co[illegible]amount of the total tax assessable for the year 1918 is $6,180.85, w[illegible]amount prorated for 154¼ days gives $2,612.04 for the adjusted average to be deducted from the invested capital as of the beginning of the year 1919.

(f–1) On or about March 15, 1919, the petitioner filed a tentative return for the calendar year 1918, and paid $311.09, being one-fourth of the estimated tax shown thereon, thereby securing an extension of time within which to file the completed return for the year 1918. On or before the final date of such extension, the petitioner filed its completed return for the calendar year 1918, the tax assessed
22 thereon amounting to $238.48, making an overpayment of $72.61 for the year 1918.

(f–2) As shown by the records of the office of the collector of internal revenue for the district of Oklahoma, the excess item of $72.61 was reported for refund on Form 751 for the month of March, 1921. (See page 116 of March 751.) Item was disallowed on Form 751 and has never been refunded.

(g–1) On page 13 of the revenue agent's report referred to in paragraph (c–1) above, in the reconciliation of net book profit with taxable net income-year 1919, the amount of $489.59 is shown as U. S. income tax paid. Also on page 12 of the said revenue agent's report in the computation of the additional tax liability for the year 1918, this amount of $489.59 is shown as the amount of tax previously paid for that year. This is an overstatement of the tax paid for the year 1918 by the amount of $178.50, as the amount of tax paid for the year 1918 was $311.09, as stated in paragraph (f–1) above. This overstatement of an unallowable deduction in the computation of net taxable income for the year 1919 results in an overstatement of the income claimed to be taxable by the amount of $178.50.

(h–1) The amount of depletion allowed by the Commissioner of Internal Revenue for the years 1917, 1918, and 1919 was computed on the cost of additional development placed on this property by the petitioner after its acquisition of same in January, 1914.

(h–2) There were 17 producing wells on this property when acquired by the petitioner, the fair market value of which wells amounted to $58,538.00 when acquired as set forth herein under paragraphs (b–1) to (b–14), inclusive.

(h–3) This fair market value amounting to $58,538.00 is subject to depletion, and the depletion computed on this basis is an allowable deduction from gross income for the years 1917, 1918, and 1919.

(h–4) The amount of depletion sustained and allowable as a deduction as shown by the Form O and engineer's appraisal report on this property is as follows:

23

Year	Amount
1917	$4,789.68
1918	4,394.67
1919	6,169.62
Total	15,353.97

(6) Wherefore the petitioner prays:

(a) That a copy of this amended petition be served upon the respondent and that he be required to appear and make answer hereto.

(b) That the board determine that the income received by the petitioner, during the calendar years 1917, 1918, and 1919, from school lands owned by the State of Oklahoma and leased for oil and gas purposes is exempt from taxation by the United States.

(c) That the board determine that the fair market value of the assets received by the petitioner in exchange for its capital stock exceeded the par value of said capital stock by the amount of $58,538.00 and that this excess value constituted a paid-in surplus.

(d) That the board determine that this paid-in surplus amounting to $58,538.00 should be included in the computation of the invested capital of the petitioner for the calendar years 1917, 1918, and 1919.

(e) That the board determine that, if the income received by the petitioner during the year 1917 is held to be taxable, the correct amount of the 1917 tax prorated to be deducted from the invested capital as of the beginning of the year 1918 is the amount of $608.66.

(f) That the board determine that the amount of a tentative tax should not be deducted from the earnings available for distribution on the date of the dividend payment.

(g) That the board determine that the amount of the divided paid from capital on November 4, 1918, prorated for the remainder of the calendar year 1918, amounts to $648.05.

(h) That the board determine that, if the income received by the petitioner during the year 1918 is held to be taxable, the correct amount of the 1918 tax prorated to be deducted from invested capital as of the beginning of the year 1919 is the amount of $2,612.04.

24 (i) That the board determine that the amount of Federal income and profits tax for the year 1918 paid by the petitioner during the year 1919 was $311.09 and that no part of this amount has been refunded to the petitioner.

(j) That the board determine that the petitioner is entitled to credit for tax previously paid amounting to $311.09 to be applied against the correct tax liability for the year 1918 as finally determined.

(k) That the board determine that the amount of depletion sustained and allowable as a deduction from gross income for the calendar years 1917, 1918, and 1919 should be computed on the basis of the fair market value of the development on the lease when acquired plus cost of additional development placed thereon by the petitioner plus amount of bonus paid for lease for second period.

(l) That the board determine that the amount of depletion sustained and allowable as a deduction from gross income for the calendar years 1917, 1918, and 1919 to be the amounts shown below or such other amounts as the facts may warrant:

Year	Amount
1917	$4,789.68
1918	4,394.67
1919	6,169.62
Total	15,353.97

(m) For such other and further relief as the nature of the case may require.

HUBERT L. BOLEN,
Counsel for Petitioner, 621 Tradesman's Nat'l Bank Building, Oklahoma City, Okla.

[*Duly sworn to by R. L. Lunsford, jurat omitted in printing.*]

25 [Exhibit "A" to amended petition omitted. Printed side page. 8-A ante.]

26 Before United States Board of Tax Appeals

[Title omitted.]

Answer to amended petition

(Excerpt from transcript of hearing Feb. 3, 1927)

Mr. DWIGHT H. GREEN. If your honor pleases, this case does not stand at issue at the present time. The situation is this: An amended petition has been filed by the petitioner and no answer has ever been entered by the commissioner and I ask leave at this time to enter a general denial for the commissioner to the allegations of fact set forth in the amended petition.

Mr. GREEN. I take it there is no objection to that?

27 Mr. BOLEN. None whatever.

Mr. GREEN. Very well. The commissioner's answer by way of general denial will be treated as having been made in the record.

Now, December 9, 1929, the foregoing answer to amended petition certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

A true copy. Teste.

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503

CORONADO OIL & GAS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Promulgated January 14, 1929

Income—Lease—Exemption—Government instrumentality.—Petitioner's income derived from the sale of oil and gas produced by it from school lands owned by the State of Oklahoma and leased

by petitioner for oil and gas purposes. Held, not exempt from Federal income and profits taxes as, under the facts proven, petitioner is not shown to be such an instrumentality of the State of Oklahoma in its performance of a governmental function, that a tax upon its income constitutes an interference with the exercise by that State of a sovereign power.

Invested capital.—Upon the evidence, held, petitioner is entitled to include in invested capital $58,538 as a paid-in surplus, and further, that it is entitled to depletion upon that additional capital asset.

Id.—Held, that respondent erred in reducing invested capital by a tentative tax.

28 T. P. Gore, Esq., Hubert L. Bolen, Esq., D. A. Richardson, Esq., and S. W. Hayes, Esq., for the petitioner.

Dwight H. Green, Esq., and Maxwell E. McDowell, Esq., for the respondent.

Findings of fact and opinion

In this proceeding the petitioner seeks a redetermination of its income and excess-profits taxes for the calendar years 1917, 1918, and 1919, for which years the respondent has determined deficiencies in the following amounts: $6,556.86, $8,637.08, and $3,040.25, respectively, making a total deficiency of $18,234.19.

The petitioner alleges that respondent erred (1) in determining that its entire net income for the calendar years under consideration was not exempt from Federal income and profits taxes, such income having been derived from the production and sale of oil and gas from school land owned by the State of Oklahoma and leased by petitioner for oil and gas purposes; and, further, if its income be subject to Federal taxation, that respondent erred (2) in not including in invested capital for the said years the amount of $58,538 as a paid-in surplus; (3) in computing the amount of depletion, allowable as a deduction, upon the basis of cost of development of the lease subsequent to the acquisition of the same by the petitioner, it being alleged that the fair market value of the development on the lease, amounting to $58,538 when acquired by the petitioner, was a part of the assets received and is subject to depletion; (4) in reducing the petitioner's invested capital in each of said years by the amount of income and excess-profits taxes payable within the taxable years upon the income of preceding taxable years; and (5) in reducing invested capital at the beginning of the year 1918 on account of a tentative tax computed and deducted from available earnings to date of dividend payment in that year.

Findings of fact

The petitioner is a corporation organized under the laws of the State of Oklahoma, with its principal office in Cleveland, in that

State, for the purpose of leasing, holding, and operating oil, gas, coal, and other mineral lands and to engage in any line of business connected therewith.

The petitioner's entire income is derived from the sale of oil and gas produced by it from certain school land owned by the State of Oklahoma and duly leased to petitioner.

As a preliminary to the admission of Oklahoma to statehood an act of Congress was passed enabling the people of Oklahoma to form a constitution, etc., which was approved June 16, 1906. Ch. 3335, vol. 34, part 1, U. S. Stat. p. 267.

The enabling act contains the following provisions:

SEC. 3, PAR. 5. That provisions shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of said State * * *.

SEC. 7. That upon the admission of the State into the Union, sections numbered sixteen and thirty-six, in every township in Oklahoma territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools * * *.

SEC. 8. * * * (Grant of other lands for university, certain educational institutions, and public institutions and buildings.)

Where any part of the lands granted by this act to the State of Oklahoma are valuable for minerals, gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: Provided, however, that agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of such mining operations. The legislature of the State may prescribe additional legislation governing such leases not in conflict herewith.

SEC. 9. That said sections sixteen and thirty-six, and lands taken in lieu thereof, herein granted for the support of the public schools, if sold, may be appraised and sold at public sale * * * the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of such schools. But said lands may, under such regulations as the legislature may prescribe, be leased for periods not to exceed ten years; * * *.

The State of Oklahoma accepted the terms and the conditions of the enabling act. The constitution of Oklahoma, art. 11, sec. 1, reads as follows:

The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the enabling act, and any other acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all money derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they are granted.

Article VI, sec. 32 provides as follows:

The governor, secretary of state, State auditor, superintendent of public instruction, and the president of the board of agriculture, shall constitute the commissioners of land office, who shall have charge of the sale, rental, disposing, and managing of the school lands and other public lands of the State, and of the funds and proceeds derived therefrom, under rules and regulations prescribed by the legislature.

The Legislature of the State of Oklahoma enacted a law authorizing and providing for the disposition, by sale and lease, of
31 the State public lands in conformity with the provisions of the enabling act, together with other regulations pertaining thereto, and also, authorizing the commissioners of the land office to adopt and promulgate rules and regulations for carrying into effect the provisions of the act.

On December 4, 1913, pursuant to a resolution adopted by the commissioners of the land office of Oklahoma, notice was given that the commissioners of the land office would receive on the 9th day of January, 1914, bids for releasing for oil and gas purposes certain described public lands belonging to the State of Oklahoma. The said notice stated that the lease would be for a term of five years, with privilege to release for an additional five years as prescribed by law and regulation; that each bidder should deposit the sum of $55,800, the appraised value of the equipment placed upon said land and used by the Southwestern Oil Fields Company; that the said lands contained fifteen producing wells; and that the total oil production from said land from January 1 to November 1, 1913, was 81,138 barrels, or an average of 8,113 barrels per month for ten months. The said notice also contained other information, which is included in the following notice sent out by the commissioners of the land office:

Rules and regulations for leasing public lands for oil and gas purposes

Bids to be received on the following described lands:

NE. ¼ and S. ½ of NW. ¼, and SW. ¼, and S. ½ of SE. ¼, all in section 16, twp. 21 N., range 8 E., Indian meridian, containing 480 acres.

Rule 1. All bids must be on forms furnished by the commissioners of the land office, and must be filed with the secretary, at four o'clock p. m., on the 9th day of January, 1914, to be opened immediately thereafter.

Rule 2. All bidders will be required to deposit a certified check or bank draft on some bank within the State, for the sum of three thousand dollars ($3,000), payable to the commissioners of the land office to be held as earnest money as outlined in the advertisement.

Rule 3. The highest responsible bidder will be required to give bond, to be approved by the commissioners of the land office
32 for the faithful performance of his contract, and to develop the land sufficiently to extract all the oil and gas thereunder with the least possible delay.

Rule 4. The royalty shall be fifty per centum (50%) of the total output of oil and gas from said lands, and all bonuses must be offered in addition to the fixed royalty. Should bonus be offered in cash, the same must be paid to the commissioners at the time of the execution of the lease, and if in oil, the bidder must offer a definite and specific percentage of the gross production in addition to the fixed royalty of fifty per centum (50%) above set out.

Rule 5. All producing wells that are now or may hereafter be drilled on adjoining properties to be offset by corresponding wells on the lands to be leased under these rules.

Rule 6. Certified copies of pipe line runs, and all sales and shipments to be furnished monthly, or on demand.

Rule 7. Accurate and reliable information concerning wells and their operation and management to be furnished on demand to the commissioners of the land office, or any one authorized to act for them.

Rule 8. The lease to conform to and be interpreted and construed by the laws of the State of Oklahoma, and the rules of the commissioners of the land office.

Rule 9. The Southwestern Oil Fields Company, a corporation, by virtue of its lease heretofore held upon said lands, under the law, is entitled to the preference right to re-lease said lands at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, said preference right to take at the highest and best bid to be exercised within five (5) days after the award by the commissioners of the land office.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

(Signed) JNO. R. WILLIAMS,
Secretary.

Under the rules of the commissioners of the land office governing bids received, the lease on the above described land was awarded to G. W. Sutton, who deposited with his bid the amount of $55,800 to be paid to the former lessees for the physical equipment lo-

33 cated thereon and used in connection with the operation of the fifteen producing wells thereon. The amount of $55,800 was the fair market value of the physical equipment as appraised by Frank Orr, duly appointed by the commissioners on September 13, 1913, to appraise such equipment, and was accepted by the prior lessees as full compensation at the time of the surrender of their prior lease. That amount did not include any value for the development of the leased property consisting of the drilling of seventeen wells.

Under the rules and regulations of the commissioners, governing the bidding for oil and gas leases on state school lands and the awarding of such leases which were in effect at the time this lease was awarded, there was no provision for appraising the cost of drilling the producing wells on leases to be advertised for re-leasing and including such appraised value in the amount to be paid by the successful bidder to the preceding lessee.

The reproduction cost of the producing wells, having an aggregate depth of 29,269 feet at the date of acquisition, was $2 per foot, or $58,538, and the estimated amount of oil to be produced from these wells over a five-year period or the duration of the lease was 76,000 barrels of oil for the lessee's 50 per cent share during the five years. The prevailing price of oil at the date of acquisition of the lease was $1.03 per barrel, representing an expected gross return of $78,280 and a present net worth to the lessee of $58,710 after deducting lifting cost and deferment in the amount of 25 per cent.

At the time that G. W. Sutton's successful bid was accepted on January 19, 1914, by the commissioners of the land office, the petitioner was not in existence. At the request of G. W. Sutton, the commissioners of the land office voted that the lease awarded to Sutton be issued to the Coronado Oil & Gas Company, whose charter was issued on January 21, 1914. The lease was duly executed, naming petitioner as lessee and being effective from January 17, 1914. G. W. Sutton and his associates, in exchange for their rights in the lease and the physical equipment on the land, received from the petitioner its note for $5,800, bonds of the petitioner in the amount of $25,000, and 250 shares of the petitioner's stock, par
34 value $100 each. The lease entered into by the commissioners of the land office and the petitioner reads as follows:

This indenture of lease, made and entered into in duplicate on this the 17th day of January, 1914, by and between the commissioners of the land office of the State of Oklahoma, hereinafter styled the lessors, parties of the first part, and Coronado Oil & Gas Company, hereinafter styled the lessee, party of the second part,

Witnesseth: That under and in pursuance of the constitution and laws of the State of Oklahoma, the said lessors, for and in consideration of the royalty, covenants, and stipulations and conditions herein expressed and hereby agreed to be paid, observed and performed by the said lessee, its successors and assigns, do hereby lease and let unto the said lessee and its successors and assigns for a term of five

(5) years from and after the date hereof all oil deposits and natural gas in or under the following described tract of land lying in the county of Pawnee, in the State of Oklahoma, to-wit:

The south half of the northwest quarter, the southwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one (21) north, range eight (8) east I. M.

Which said lands are public lands belonging to the State, and were by the said commissioners of the land office declared to be valuable for oil and gas purposes, and the said oil and gas deposits therein contained were by the said commissioners of the land office segregated from the surface use and interest therein, with the right to prospect for, extract, pipe, store, refine and remove such oil and natural gas, with the right to use and keep so much of the said surface of said premises as may be necessary to prospect for, extract, pipe, store, refine, and remove such oil and natural gas, including still further the right to use a sufficient amount of such oil and natural gas as fuel, light and power so far as may be necessary to the prosecution of said operations, and with the further right to use any water on said premises that may be necessary to carry on said operations, in consideration whereof the lessee hereby agrees to pay a royalty of fifty (50%) per centum of all the oil and gas produced and sold from the fifteen wells now in operation upon the said premises, and to operate the same to their full capacity, and not to abandon or plug any well now upon the said lands without written consent of the commissioners of the land office first obtained in writing.

All oil and gas due to the State under this contract shall be delivered by the lessee herein or his assigns free of cost to the State into pipe lines, tanks, or cars, or settled for before removing the same from the premises if sold in any other way. Certified copies of gauge tickets, sales, and shipments to be furnished at the request of the commissioners or any one authorized to act for them; gas to be metered on the premises under high pressure unless some other method of gauging and measuring same shall be hereafter agreed upon in writing.

The lessee further covenants and agrees to exercise diligence in the sinking of wells for oil and gas purposes on the lands covered by this lease, and to drill a sufficient number of wells on said premises to offset each and every well drilled upon adjoining premises, and the said lessee is hereby required and binds itself to develop said premises as is required by the laws of the State of Oklahoma and the rules and regulations adopted by the commissioners of the land office.

Whenever any well shall hereafter be drilled adjoining said premises and such well shall produce oil or gas in paying quantities, then within fifteen days thereafter the lessee herein shall begin the drilling of offset wells as above provided and development of oil and

gas on such land herein shall be sufficient to extract all oil and gas therefrom with the least possible delay.

The said lessee shall operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such lands are located, and the failure to do so shall forfeit this lease to the State, and thereupon the commissioners of the land office shall be entitled to take immediate possession of said lands and all improvements thereon. Accurate and reliable information concerning all wells and their operation and management to be furnished on demand of
36 the commissioners of the land office. The said party of the second part further agrees to carry on operations in a workmanlike manner to the fullest possible extent; to commit no avoidable waste on the said land, and to suffer no avoidable waste to be committed upon the portion of its occupancy or use; to take good care of the same, and to promptly surrender and return the premises upon the termination of this lease.

The tools, boilers, power houses, lines, pumping and drilling outfits, tanks, engines and machinery (and casing of all dry and exhausted wells) shall remain the property of the party of the second part, and may be removed by them at any time before or at the expiration of this lease.

The casing, derricks, boilers, power houses, power plants, lines, tanks, tubing, rods, pumping and drilling outfits, engines and machinery, tools and all other appliances necessary to be used in the operation of any producing well on the lease, shall be appraised six months prior to the expiration of this lease contract, in order to ascertain the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office, and one by the lessee herein named or its assignee holding said lease at the time, and if said appraisers be unable to agree upon the fair and reasonable value of all such property of the lessee or its assigns on said premises the two appraisers so appointed shall have the right and authority to appoint a third person, and the appraisement of a majority of said three appraisers shall be binding upon both parties hereto. It being expressly understood that the actual sale value of the materials and improvements mentioned at the time of appraisment shall alone be considered and no expense incurred in drilling, except materials permanently used in the operation of the well, shall be considered as improvements.

In advertising said land for release for a second term of five years, the appraised value of said property of the lessee on the lease shall be stated in said advertisement, and any bidder other than the lessee herein named or its assignee shall be required to deposit the appraised value thereof with the commissioners of the land office at the time the bid for the second term of five years is made, and
37 if the lessee herein named or its assignee does not succeed in leasing said premises for a second period of five years,

then in that event said amount shall be paid over to the lessee, herein named or its assignee, provided, however, that all royalties, rentals, charges, and claims have been paid; that it will not permit any nuisance to be maintained on the premises under its control; that it will not use such premises for any other purpose than those authorized in this lease. Said second party further obligates itself and agrees not to plug, abandon, or pull the casing from any well, productive or otherwise, without first securing the written consent of the first party, or its duly authorized agent, and it is further mutually agreed that a violation of this provision shall work a forfeiture of this lease at the option of the first party, and that before abandoning any well under said written consent it will securely plug the same so as to effectually shut off all water above and below the oil bearing horizons according to law.

And the said party of the second part further covenants and agrees that it will keep an accurate account of all oil and gas mining operations, showing the sales, prices, dates of purchase, and the whole amount of oil and gas mined and removed; and all sums due as royalties shall be a lien on all implements, tools, movable machinery and all other personal chattels used in said prospecting and mining operations and upon all the unsold oil obtained from the land herein leased as security for the payment of said royalty.

And it is mutually understood and agreed that this indenture of lease shall in all respects be subject to the rules and regulations heretofore or that may hereafter be lawfully prescribed and not in conflict with the lawful terms of this lease by said commissioners relative to oil and gas leases of public lands, and that this lease or any interest therein shall not be sublet, assigned or transferred without the consent of the commissioners of the land office first obtained in writing. And it is further mutually understood and agreed that this lease is not executed to or in the interest of any pipe line or transportation company, or any company allied to or confederated therewith or any subsidiary company thereof, nor any other
38 company, corporation, person or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative or employee, acting singly or as a firm, or corporation of such companies or either of them, and that should the second party or its assigns violate any of the covenants, stipulations or provisions of this lease, or any of the regulations, or fail for a period of sixty days to pay the stipulated royalties provided herein, then the commissioners, after ten days' notice to the parties hereto, shall have the right to avoid this indenture of lease and cancel the same.

If the lessee makes reasonable and bona fide efforts to find and produce oil in paying quantities as herein required of it, and such effort is unsuccessful, it may at any time thereafter surrender and wholly terminate this lease upon the full payment and performance of all its then accrued and payable obligations hereunder.

It is agreed that for any refinery of crude oil and its products and by-products owned and controlled by the State of Oklahoma the State shall have the preference right to purchase and receive the output from said premises at the market prices therefor; providing that the lessee may sell the said output to any firm, corporation or person whatsoever until notice in writing from the commissioners of the land office has been served upon the lessee that the State of Oklahoma is ready to take such oil or gas or either of them.

The lessee, its successors, or assigns, shall have the preference right to re-lease said premises for a second term of five years at the expiration of this lease, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor at the time of such renewal. Said maximum rate shall be determined by such reasonable and lawful regulations as are now or may hereafter be prescribed by the commissioners of the land office or other persons or persons authorized thereto by the State of Oklahoma.

The term "Commisisoners of the land office of the State" as used in this lease shall include any board, person, or persons who are or may hereafter be authorized by law to act in behalf of the State in the matters relating to the leasing of the public lands of the State of Oklahoma for oil and gas purposes.

89. It is further agreed and understood that the approval of this lease by the commissioners shall be of no force nor effect unless the party of the second part furnish a bond in the sum of ten thousand dollars ($10,000.00) to the satisfaction of said commissioners, in accordance with the regulations of said commissioners, which shall be deposited and remain on file in the office of the commissioners of the land office of Oklahoma.

And it is agreed that the lessee shall, at the expiration of each quarter after the premises produce oil and gas, or either of them, make and file with said commissioners a production report showing the full amount of the production of oil and gas, or either of them, for the quarter prior to the said report, and whenever said production reports, computed together or singly vary from the sales report, the lessee, upon the proper showing and proof shall be given credit on the production report or reports for the amount of shrinkage.

The said lessee binds and obligates itself to do and perform all of the conditions imposed on it by law and this lease and obligates itself to protect the State of Oklahoma from all damage, loss, charges, and claims of every kind or nature, by reason of a failure to comply in whole or in part with the terms of this lease, and in the event that lessee fails, neglects, or refuses to comply with the terms of this lease as herein imposed, this lease and all rights and privileges inuring to the benefit of the said lessee may be forfeited and cancelled, and the said commissioners for and on behalf of the State of Oklahoma shall be entitled to recover from the lessee's bondsmen all rents, royalties, charges, and claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease.

In witness whereof, the said parties have hereunto subscribed their signatures, the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By LEE CRUCE,
Governor of the State of Oklahoma and Chairman of said Commissioners.

40 Attest:
[SEAL.]
JOHN R. WILLIAMS,
Secretary.

CORONADO OIL AND GAS COMPANY,

(Signed) By G. W. SUTTON, *President.*

Attest:

GEORGE REYNOLDS.

Under date of January 17, 1917, the commissioners of the land office and the petitioner entered into a supplemental agreement permitting petitioner to drill additional wells and to pay a royalty of 12½ per cent on oil and gas produced from such additional wells, but in nowise affecting the 50 per cent royalty on the oil from wells already drilled and producing. The primary purpose of that supplemental agreement was to enable petitioner to drill offset wells to prevent drainage of oil from the leased school land.

Upon the expiration of petitioner's lease in January, 1919, the lands covered by said lease were duly advertised for re-lease subject to the preference right of petitioner. At that time the regulation governing the determination of the sum to be paid the prior lessee by the succeeding lessee, had been changed so that the appraisal of property to be surrendered by the prior lessee included not only the fair value of the physical equipment on the land, but also the fair value of the improvements, namely, the drilled and producing wells. On March 18, 1919, the commissioners of the land office received all bids and awarded the lease to petitioner, effective as of the date of the expiration of its prior lease in January, 1919. The lease reads as follows:

This indenture of lease, made and entered into in duplicate, on this Jan. day of 17th A. D., 1919, by and between the commissioners of the land office of the State of Oklahoma, acting for and in behalf of the State of Oklahoma, parties of the first part, hereinafter designated as lessor, and Coronado Oil & Gas Company, of Cleve-
41 land, Oklahoma, party of the second part, hereinafter designated as lessee, under and in pursuance of the provisions of the constitution and laws of the State of Oklahoma, relating to the segregation of the oil and gas deposits and the leasing thereof on school and other public lands belonging to the State of Oklahoma, witnesseth:

1. The lessor, for and in consideration of four hundred and eighty No/100 ($480.00) dollars, the receipt whereof is hereby acknowl-

edged, and of the royalties, covenants, stipulations, and conditions hereinafter contained and hereby agreed to be paid, observed, and performed by the lessee, and his lawful assigns, does hereby demise, grant, lease, and let unto the lessee for the term of five years from the date hereof, and as long thereafter as oil or gas or either of them is produced in paying quantities, all the oil deposits and natural gas in or under the following described tract of land lying and being within the county of Pawnee, in the State of Oklahoma, to wit:

Northeast (NE. ¼) quarter; south-half of northwest (NW. ¼) quarter, south-half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) quarter of section sixteen (16) township twenty-one (21) north range eight (8) E. I. M.

and containing 480 acres, more or less, with the exclusive right to prospect for, extract, pipe, store, and remove oil and natural gas, and to occupy and use so much only of the surface of said land as may reasonably be necessary to carry on the work of prospecting for, extracting, piping, storing, and removing such oil and natural gas. Also the right to obtain from wells or other sources on said land by means of pipe lines or otherwise, a sufficient supply of water to carry on said operations, except the private wells or ponds of the surface owner or lessee, and also the right to use, free of cost, oil, and natural gas as fuel so far as necessary to the development and operation of said property.

2. The lessee hereby agrees to deliver or cause to be delivered to the commissioners of the land office of the State of Oklahoma, or their successors, a royalty, of one-eighth part of the oil or gas
42 produced from the leased premises or in lieu thereof pay to the State the market value of said royalty interest, as the commissioners may elect. All oil and gas due to the State under this contract, shall be delivered by the lessee herein, free of cost, into pipe lines, tanks, or cars, or settled or paid for before removing same from the premises if handled in any other way. The lessee shall furnish to the lessor certified copies of gauge tickets, sales, shipments, and amount of gross production, at their office in Oklahoma City. Gas to be metered on the premises under high pressure, unless some other method of gauging and metering same shall be hereafter agreed upon by the parties hereto in writing.

3. The lessee shall exercise diligence in sinking wells for oil and natural gas on the land covered by this lease, and shall drill a sufficient number of wells to offset the wells upon adjoining contiguous premises, said offset wells to be commenced within 10 days after completion of any producing well upon such adjoining contiguous premises, unless a different time is prescribed by notice in writing from the lessor, and be prosecuted diligently and continuously until completed; and the said lessee shall operate the leased premises for oil and gas to same extent as individual and corporate premises are being operated within the general oil and gas fields where such land is located, and failure to faithfully comply with this provision shall be cause for forfeiture of this lease to the State.

At least one well, producing oil or gas in paying quantities, shall be drilled and completed within one year from the date hereof, or failing so to do the lessee shall pay to the lessor for each whole year the completion of such well is delayed, for not to exceed five years from the date hereof, in addition to the other consideration named herein, a rental of one ($1.00) dollar per acre, payable annually, in advance, and if the lessee shall fail to drill at least one such well within any such yearly period, and shall fail to surrender this lease on or before the end of any such year during which the completion of such well is delayed, such failure shall be taken as conclusively evidencing the election and covenant of the lessee to pay the rental of one ($1.00) dollar per acre for such year, and thereupon the lessee shall be absolutely obligated to pay such rental. The failure of the lessee to pay such rental before the expiration of fifteen
43 (15) days after it becomes due at the end of any yearly period during which a well has not been completed as herein provided shall be a violation of one of the material and substantial terms and conditions of this lease, and be cause for cancellation thereof, but such cancellation shall not in any wise operate to release or relieve the lessee from the covenants and obligations to pay such rental or any other accrued obligation. It being understood that the completion of one well, producing oil or gas in paying quantities during the life of this lease, shall relieve the lessee of all future liability for said $1.00 per acre hereunder, but the lessee shall nevertheless remain obligated to drill an offset, or necessary offsets, and other wells necessary to the proper development and operation of said lease as herein otherwise provided; and provided further that unless a producing well of oil or gas is completed on the above described premises within five years from date hereof this lease shall be void.

4. The lessee shall carry on the development and operation in a workmanlike manner; commit no waste on said land, and suffer none to be committed upon the portion in his occupancy or use; taken good care of the same, and promptly surrender and return the premises upon the termination of this lease to the lessor, or to whomsoever shall be lawfully entitled thereto, unavoidable casualty only excepted.

All tools, derricks, boilers, boiler houses, pipe lines, pumping and drilling outfits, tanks, engines and machinery, and the casing of all dry or exhausted wells shall remain the property of the lessee, and may be removed at any time prior to or at the termination of the lease by forfeiture or otherwise; and the lessee shall not permit any nuisance to be maintained on the premises; and shall not use said premises for any purposes than those authorized in the lease; and before abandoning any well, shall securely plug the same so as to effectually shut off all water from the oil bearing stratum, or in the manner required by the laws of the State of Oklahoma.

5. The lessee shall keep an accurate account of all oil and gas mining operations, including a log of each well drilled, duly sworn to by the contractor or driller, which shall be filed with the

secretary to the commissioners of the land office within thirty days after said well is completed. Accurate and reliable information concerning all wells and their operation and management shall be furnished to the commissioners of the land office or their representatives upon demand. The said lessee shall also keep an accurate account showing the sales, prices, dates, purchases, and the whole amount of oil and gas mined or removed, and all sums due as royalties shall be a lien on the implements, tools, and movable machinery or personal chattels used in operating said property, and also upon all the unsold oil and gas obtained from the land herein leased as security for the payment of said royalties.

6. The lessee shall be liable to the surface owner or surface lessee for all damages or loss accruing to the surface interests in said land, and to all crops and improvements thereupon and appurtenances and hereditaments thereunto belonging by reason of the oil or gas mining operations hereunder, and in the event the amount of such damage can not be agreed upon by the lessee hereof and such surface owner or lessee, then the amount of such damage shall be determined as is or may be provided by law. The lessee hereof further agrees to pay all such damages within ten days after the amount thereof is determined, and the amount of such damages may be recovered from the lessee hereof and his sureties upon the bond given to secure the faithful performance of this lease.

7. This lease shall be subject to the constitution and laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office now or hereafter in force relative to such leases; all of which are made a part and condition of this lease: Provided, That no regulations made after the execution of this lease affecting either the length of the term hereof, the rate of royalty, or payment hereunder or the assignment hereof, shall operate to affect the terms and conditions of this lease.

8. No transfer or assignment of this lease, or any part thereof, shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office; and such assignee shall furnish a bond to the satisfaction of the commissioners of the land office, conditioned for the faithful performance of the covenants and conditions of this lease, and pay an assignment fee of five dollars.

9. Before this lease shall be in force and effect the lessee shall give a good and sufficient bond in the sum of two thousand & no/100 ($2,000.00) dollars, to be approved by the commissioners of the land office, for the faithful performance of this lease.

10. Upon the violation of any of the substantial terms or conditions of this lease, the commissioners of the land office shall have the right at any time after hearing upon ten days' notice, given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the said premises, specifying the terms or conditions violated, to declare this lease null and void; and the said commissioners for and on behalf of the State

of Oklahoma, shall be entitled to recover from the lessee's bondsmen, all rents, royalties, charges, claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease, on failure to comply with the provisions thereof, and the lessors shall be be entitled and authorized to take immediate possession of the land.

11. It is further agreed that for any refinery of crude oil and its products and by-products, owned and controlled by the State of Oklahoma, the State shall have the preference right to purchase and receive the output from said premises at the market price thereof; provided, that this clause shall not prevent the lessee from selling the output of said leases to any person, firm or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas or either of them, and all sales of oil and gas or either of them under this proviso shall be valid and binding.

12. The lessee may at any time hereafter surrender and wholly terminate this lease upon payment of the rentals and other liabilities then accrued and due hereunder, and may exercise such right by filing a formal relinquishment and release of the said lease with the secretary to the commissioners of the land office: Provided, that if such lease has been recorded, by causing the release thereof
46 to be filed and recorded in the proper recording office, and upon a compliance with these requirements such lessee shall thereby be relieved from liability for rental thereafter accruing.

13. The surface owner or lessee of the said premises shall have gas free of cost from any well on said premises for domestic use thereon by making his own connection with the well.

In witness whereof the parties hereunto subscribed their signatures on the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By J. B. A. ROBERTSON,
Governor and Chairman.

Attest:

(Signed) A. S. J. SHAW,
Secretary to the Commissioners of the Land Office.

CORONADO OIL & GAS COMPANY,
Lessee.

(Signed) By R. L. LUNSFORD,
President.

Attest:

(Signed) J. B. MYERS, *Treas.*

Petitioner's only source of income during the years under consideration was from the sale of oil and gas produced from the lands leased as aforesaid and respondent determined such income to be taxable.

Respondent excluded from petitioner's invested capital the amount of $58,538, which petitioner claims should be included therein as a paid-in surplus representing the value of the improvements and producing wells on the leased lands at the date of acquisition and respondent also excluded the said amount from the basis upon which he computed the allowed deductions for depletion.

In computing petitioner's invested capital for the year 1918, respondent reduced the same by the amount of $1,336.99 on
47 account of a dividend of $20,000 paid November 4, 1918, prorated out of invested capital after applying thereto the available earnings to date of payment less tentative tax.

Opinion

TRUSSELL: The taxes here involved are for the calendar years 1917, 1918, and 1919, and the deficiencies appealed from have been determined under the revenue acts of 1916, 1917, and 1918. By section 10 of the first mentioned act, which is carried into the two subsequent acts, a tax is imposed upon the net income of "every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized," with the exception of corporations operated for certain specified purposes, which need not be here detailed, as it is not claimed that petitioner falls within one of these excepted classes.

It is not questioned that petitioner is a private domestic corporation, created and operated for the personal and private gain of its individual stockholders, and that the property from which the income in question was derived, consisting of a lease of oil lands and physical assets represented by the operating equipment on those lands, belonged to it and represented the personal investment of its stockholders. It will thus be seen that petitioner is subject to tax upon its income unless entitled to some exemption, and that such exemption, if it exists, is not granted by the taxing statute.

Petitioner claims that its income during the taxable years in question is exempt from Federal taxation for the reason that it was all derived from the sale of oil and gas produced from public-school lands leased from the State of Oklahoma, that by its lease of such lands from the State it became the instrumentality through which the latter derived part of its public-school fund, and that to tax its income is to burden the State in the performance of its governmental function of maintaining public schools. In approaching the question we must bear in mind that exemption from tax is never presumed, but, on the other hand, the presumption is in favor of the taxing power, and the burden is upon the claimant to establish
48 clearly and beyond doubt its right to exemption. It is well recognized that "taxation is the rule and exemption the exception." Cooley on Taxation, vol. 1, p. 356.

The mere fact that the property of the State of Oklahoma is exempt from Federal taxation does not grant such immunity to a

lessee of that property, as it is well recognized that the right to use property is distinct from the fee and that a tax upon the interest of the lessee is not a tax upon that of the lessor. In Heiner v. Colonial Trust Co., 275 U. S. 232, the court held the lessee of tax-exempt Indian lands liable to Federal income tax upon the ground that the exemption of the lessor by Congress could not be presumed to extend to those doing business with him.

In Jetton v. University of the South, 208 U. S. 489, there was involved the right of the State to lay a tax upon the interest of a lessee in property belonging to a lessor who was specifically exempted from taxation by statute, it being claimed that the tax violated the legislative contract of the statute, as it lessened to that extent the value of the leasehold interest to the lessor and thus indirectly burdened him with the tax. In denying exemption to taxation to the lessee the court said:

As long as different interests may exist in the same land, we think it plain that an exemption granted to the owner of the land in fee does not extend to an exemption from taxation of an interest in the same land granted by an owner of the fee to another person as a lessee for a term of years. The two interests are totally distinct, and the exemption of the one from taxation plainly does not thereby exempt the other.

In Elder v. Wood, 208 U. S. 226, the right of the State of Colorado to tax a mining claim belonging to an individual was questioned, the fee in the land upon which the claim was located being in the United States. The court in sustaining the right to tax held that the property taxed was "the right of possession of the land for mining purposes," which belonged to the individual, saying:

Such an interest from early times has been held to be property, distinct from the land itself, vendible, inheritable and taxable.

That the State may not impose a tax which interferes with the free exercise by the Federal Government of the powers granted it by the Constitution, and that a privilege or occupation tax upon an instrumentality which represents, in its creation or use a direct exercise of such powers, is an interference therewith, can not be questioned.

In McCullough v. Maryland, 4 Wheat. 316, the right of the State was denied to impose a privilege or occupation tax upon the Bank of the United States, a corporation created by Congress, upon the ground that Congress possessed the power to create such a corporation and the grant of such power by the Constitution implied such immunity as necessary to maintain the free exercise thereof and accordingly the taxation by the State of the thing created, the corporate body, was an interference with the exercise of such power. Following this decision the courts in many decisions have affirmed and applied this rule. Osborn v. Bank, 9 Wheat. 738; Weston v. City Council of Charleston, 2 Pet. 449; Dobbins v. The Commissioners of Erie County, 16 Pet. 436; Van Allen v. Assessors, 3 Wall.

578; Bradley v. People, 4 Wall. 459; National Bank v. Commonwealth, 9 Wall. 353; Van Brocklin v. State of Tennessee, 117 U. S. 151; Northern Pacific R. R. Co. v. Smith, 171 U. S. 261; Grether v. Wright, 75 Fed. 742; Home Savings Bank v. Des Moines, 205 U. S. 503; Farmers' Bank v. Minnesota, 232 U. S. 516; Johnson v. Maryland, 254 U. S. 51.

The converse of this rule, a corresponding limitation upon the power of the Federal Government to interfere with the exercise by the States of the powers reserved to them, is equally well established.

In Collector v. Day, 11 Wall. 113, it was held that the Federal Government had no right to impose a tax upon the salary of an executive officer of a State, the court saying:

And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, equally exempt from Federal taxation?

Their unimpaired existence in the one case is as essential as in
50 the other. It is admitted that there is no express provision in the Constitution that prohibits the General Government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that Government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government.

In Pollock v. Farmers Loan & Trust Co., 157 U. S. 584, the court said:

As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the INSTRUMENTALITIES OR THE PROPERTY of a State.

In Ambrosini v. United States, 187 U. S. 1, the power of the Federal Government was denied to levy a stamp tax on bonds given a State under a requirement of its law. The court said:

The general principle is that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government.

The application of these rules has, however, been limited to those cases where the Federal Government or the State in its employment and use of an instrumentality was performing some definite governmental function peculiar to its sovereign character. It is held not to apply to the case where a private individual or corporation merely deals with the Federal Government, or with the State for private gain under a contract executed by the latter as an incident of the exercise of one of its governmental powers.

In Baltimore Shipbuilding Co. *v.* Baltimore, 195 U. S. 375, the Supreme Court, speaking through Justice Holmes, said: But, furthermore, it seems to us extravagant to say that an independent private corporation for gain, created by the State, is exempt from State taxation, either in its corporate person, or its property, because it is employed by the United States, even if the work for which it is employed is important and takes much of its time.

In Fidelity & Deposit Co. *v.* Pennsylvania, 240 U. S. 319, the corporation claimed immunity from taxation by the State on premiums collected by it on bonds executed under authority of an act of Congress allowing it to be accepted as surety on bonds required by laws of the United States, charging that its transactions with the Federal Government thereunder constituted it a governmental instrumentality. In holding that it was subject to taxation by the State on such business the court said:

But mere contracts between private corporations and the United States do not necessarily render the former essential governmental agencies and confer freedom from taxation.

In Osborn v. The Bank, supra, where it was held that the Bank of the United States was not a private corporation but a public one, created for national purposes and accordingly not subject to taxation by the State, Chief Justice Marshall, for the court, conceded that had it been a private corporation, with private trade and profit its purpose, it would be subject to State taxation. The learned Chief Justice said that had this been the case—

This mere private corporation engaged in its own business, with its own views, would certainly be subject to the taxing power of the State, as any individual would be; and the casual circumstance of its being employed by the government in the transaction of its fiscal affairs would no more exempt its private business from the operation of that power than it would the private business of any individual employed in the same manner.

In Flint *v.* Stone Tracy Co., 220 U. S. 108, the court, after citing the authorities holding that the State can not tax agencies
52 or corporations which are created for the purpose of carrying out governmental functions of the United States, said:

An examination of these cases will show that in each case where the tax was held invalid the decision rested upon the proposition that the corporation was created to carry into effect powers conferred upon the Federal Government in its sovereign capacity, and the attempted taxation was an interference with the effectual exercise of such powers.

In this case the court in its discussion of the right of the Federal Government to tax instrumentalities of the State said:

The true distinction is between the attempted taxation of those operations of the States essential to the execution of its Governmental functions, and which the State can only do itself, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the State in

carrying out its purposes; the latter, although regulated by the State and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate Federal taxation.

And so in Grover *v.* Standard Dredging Co., 224 U. S. 362, it was held that the property of a contractor employed by the United States was not exempt from taxation even though exclusively used for the carrying out of the contract.

The Supreme Court has also drawn a definite distinction between those cases in which the State was exercising a purely governmental power and one merely incident, and equivalent to the carrying on of a private business, although the agency employed was one representing the interest of the State alone. In South Carolina *v.* United States, 199 U. S. 437, there was presented the right of the Federal Government to lay an excise tax upon the agents employed by the State of South Carolina to operate the State liquor dispensary under the provisions of a statute of that State under which it took over the exclusive sale of liquor, this statute having been held constitutional by the Supreme Court as a proper exercise of
53 its sovereign police power. In this case the business carried on by the agents was wholly an activity of the State itself, all of the net profits were revenue to the State and any burden by way of tax on the business was directly reflected in a lessening of the revenue it ultimately received. The court, after reviewing the authorities, in sustaining the right of the Federal Government to tax this instrumentality of the State said:

So here the charge is not upon the property of the State, but upon the means by which that property is acquired, and before it is acquired.

It is also worthy of remark that the cases in which the invalidity of a Federal tax has been affirmed were those in which the tax was attempted to be levied upon property belonging to the State, or one of its municipalities, or was a charge upon the means and instrumentalities employed by the State, in the discharge of its ordinary functions as a government.

Many cases have arisen calling for the application of the general rules discussed, and the courts have recognized that the question is not one in which a hard and fast rule may be laid down which may be applied to every case of attempted taxation of a State or Federal agency. The reason for this is that the question in each case is whether or not, under the particular facts involved, the tax constitutes an interference with the exercise of a sovereign power. The objection to it, in any case, rests not upon the fact that it is a tax but that it is an interference with the exercise of a power which is immune from interference. Even where the levying of the tax interferes with the exercise of a right possessed by the State, it may not constitute an interference with its necessary governmental powers. This is illustrated by the case of Veazie Bank v. Fenno, 8 Wall. 533. In this case the Federal Government levied a tax upon the circulation of a State bank, the question being practically the

converse of that involved in McCullough v. Maryland, supra. In sustaining the validity of the tax the Supreme Court admitted that the right to create such a bank was not surrendered by the State in the grant of power to the Federal Government by the Constitution, but such a power was not one of these necessary to be kept free from interference to maintain the sovereignty of the
54 State. The court in that case points out those functions of the State which are sovereign in the following words:

It may be admitted that the reserved rights of the States, such as the right to pass laws, to give effect to laws through executive action, to administer justice through the courts, and to employ all necessary agencies for legitimate purposes of State government, are not proper subjects of the taxing power of Congress. But it cannot be admitted that franchises granted by a State are necessarily exempt from taxation; for franchises are property, often very valuable and productive property; and when not conferred for the purpose of giving effect to some reserved power of a State, seem to be as properly objects of taxation as any other property.

And so it has been held that where the effect of the tax was merely to cause the Federal Government or the State to receive less income than it would had the tax not been imposed, it is not an interference with its sovereignty as a tax upon its property. In this connection it is noted that the courts have held proper a succession tax levied upon legacies of property to the Federal Government or the State, the effect of which tax was to lessen the amount ultimately received under the legacy. Thus, in United States v. Perkins, 163 U. S. 625, a succession tax of the State of New York was sustained, although the property charged was bequeathed by will to the United States, and in Snyder v. Bettman, 190 U. S. 249, a Federal succession tax was sustained although the bequest in question was to the city of Springfield, Ohio.

In Railroad v. Peniston, 18 Wall. 5, the court, in holding that a tax upon the property of a government instrumentality was not an interference with the exercise of the governmental power to do those things which it is carrying into effect through the agent, said:

It is therefore manifest that exemption of Federal agencies from State taxation is dependent not upon the nature of the agents or upon the mode of their constitution or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve
55 the Government as they were intended to serve it, or does it hinder the efficient exercise of their power.

In Metcalf & Eddy v. Mitchell, 269 U. S. 515, the right of the United States was questioned to tax such portion of the incomes of two partners in an engineering firm as represented payments made the partnership by certain States and municipalities for services rendered as consulting engineers, it being claimed that as to the employment for which they were paid they were agents of the State governments and as such exempt from taxation. The court, after

reviewing the authorities, in restating the rule as announced in Railroad *v.* Peniston, supra, that the fact of whether or not the tax constituted an interference was one for determination under the facts of each case as submitted, said:

As cases arise, lying between the two extremes, it becomes necessary to draw the line which separates those activities having some relation to government, which are nevertheless subject to taxation, from those which are immune. Experience has shown that there is no formula by which that line may be plotted with precision in advance. But recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. Its origin was due to the essential requirement of our constitutional system that the Federal Government must exercise its authority within the territorial limits of the States; and it rests on the conviction that each government, in order that it may administer its affairs within its own sphere, must be left free from undue interference by the other. McCulloch *v.* Maryland, supra; Collector *v.* Day; Dobbins *v.* Commisisoner or Erie County, supra.

In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of Federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the States, and vice versa. Taxation by either the State or the Federal Government affects in some measure the cost of operation of the other.

56 But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation can not be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (South Carolina *v.* United States, 199 U. S. 437, 461; Flint *v.* Stone Tracey Co., supra, at 172) or the appropriate exercise of the functions of the government affected by it. Railroad Co. *v.* Peniston, supra, 18 Wall. 31.

We think it clear under the decisions that had the lands in question been merely State lands burdened with no special trust and held for general State purposes, there would be no question but what petitioner, as an individual lessee for private gain, would not be entitled to exemption from Federal taxation. It could not be claimed that it was an instrumentality of the State when the lease of the land would be no more than an exercise or a right of ownership by the State, a right possessed by any individual and in no sense requiring an exercise of the power peculiar to sovereignty, or in the language of the court in Flint v. Stone Tracey Co., supra, "an act essential to the execution of its governmental function and which the State can only do itself." However, in the present case, it is claimed that the

lands leased are a part of those ceded by the National Government to the State of Oklahoma, by the enabling act, for the definite and specific purpose of creating a permanent school fund to be administered in trust by the State for the maintenance of its public schools; that the acceptance of the grant created a trust in respect to such lands, undertaken by the State in its sovereign capacity, and that its every act toward performance of the trust and obtaining a school fund was one in carrying out a sovereign obligation; that in maintaining its public schools it is exercising a governmental function and that the lessees of school lands are its instrumentalities employed in the exercise of such function and accordingly exempt from Federal taxation. In support of its contention petitioner cites
57 certain decisions by the Supreme Court upon questions arising in connection with leases of tax-exempt Indian lands.

In Choctaw O. & G. R. Co. v. Harrison, 235 U. S. 292, the right of the State of Oklahoma was disputed to levy upon a railroad company an occupation tax computed upon the gross sales of coal mined by it under leases to it by the Federal Government of tax-exempt Choctaw and Chickasaw Indian lands. The court held that the treaty between these Indian tribes and the Federal Government imposed upon the latter a definite duty in respect to opening and operating these mines in their interest, and that the railroad company was the instrumentality through which this obligation was carried into effect, and as such could not be subjected to an occupation or privilege tax by the State.

In Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522, there was questioned the right of the State of Oklahoma to subject an oil and gas lease on tax-exempt Osage Indian lands to general taxation. The court held that the property in question was under the protection of the Federal Government and that the leases "have the immunity of such protection." The court further said that "it follows from these views that the assessment against the oil company, so far as it included the leases, whether as separate objects of taxation or as represented or valued by the stock of the company, is invalid."

The same principal was applied in Howard v. Gypsy Oil Co., 247 U. S. 503; and Large Oil Co. v. Howard, 248 U. S. 549, involving gross-production taxes.

In Gillespie v. Oklahoma, 257 U. S. 501, a lessee of tax-exempt Indian lands, from the Federal Government, disputed the right of the State of Oklahoma to exact a tax based upon the net income derived from operations under the lease. In holding such taxes invalid the court said:

The same consideration that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards.

It is insisted that the condition presented in this proceeding
58 is substantially similar to the one involved in the last cited case and that upon this and the other cases cited petitioner must be considered an instrumentality employed by the State of Oklahoma in the exercise of one of its sovereign powers and that to tax its income is to interfere with the exercise of that power.

In the cases cited the lands were held by the Federal Government in trust for Indian tribes. The beneficiaries of the trust were dependent wards in respect to whom a duty rested upon the Government to exact a maximum income from the trust property. The obligation of the trust was one assumed by treaty ratified by Congress and for that reason peculiarly sacred and inviolate as involving the national honor. These treaties are obligations of sovereignty and have the same effect as treaties with foreign nations. United States v. New York Indians, 173 U. S. 464; Turner v. American Baptist Missionary Foundation, 24 Fed. Cases 14251. An obligation to develop these Indian lands and to extract their mineral resources for these wards are ones specifically assumed by the Federal Government under the treaties, and the court has held that this laid upon the latter, as a sovereign, an obligation to obtain the best terms possible for its wards, and that to impose a tax upon the instrumentality through which it performs its duty, interferes with the carrying out of its obligation. In the execution of the leases involved in the cases cited the Federal Government was not merely leasing its public lands in securing revenue, but carrying out a sovereign treaty obligation.

We do not see in the facts presented in the proceeding before us a condition similar to that involved in leases of Indian lands. In the language of the court in Metcalf & Eddy v. Mitchell, supra; in referring to the Gillespie case, the condition there involved was one of taxation by one government of "an agency created and controlled by the other, exclusively to enable it to perform a governmental function." We have no such condition here. Petitioner is merely one of many lessees of school lands and if an instrumentality of the State in its furnishing of public education it is only one of many agencies of various kinds and characters, made use of as an incident of the performance of its governmental function. In this connection see Choctaw O. & G. R. Co. v. Mackay, 256 U. S.
59 531, holding that a tax upon merely one of several agencies employed by the United States in discharging its obligations toward its Indian wards can not be considered as an interference with its exercise of its governmental power to carry out that obligation. It is not controlled or directed by the State to any further extent than any other lessee of public lands. We can not see in the two cases a similarity controlling the conclusion to be arrived at in the present case.

It is true that these lands were received by the State of Oklahoma from the Federal Government to be used for the creation of a

school fund but can it be said that the act of the State in leasing them is, in view of that fact, of a different and more sovereign character than the leasing of its other public lands to obtain revenue for general State purposes. We can see in the trust arising from the ceding of these lands to the State of Oklahoma for the creating of a school fund nothing more than a designating or setting aside of this property for this purpose. The authority of the State in respect to these lands was, in so far as control and disposition of them was concerned, substantially the same as in respect of its other public lands, except that the proceeds from sale or lease should not go into its general revenues but into a permanent school fund, which was to be maintained intact, and the income therefrom used for its public schools. Can it be said that one who leases such lands from the commissioners of the land office, the instrumentality through which the State of Oklahoma controls and disposes of all of its public lands, is thereby constituted an instrumentality of the State in the performance of its governmental function of maintaining public schools, or an instrumentality of that State in the performance of a trust in respect to such lands assumed by it in its sovereign capacity, and therefore exempt from income tax upon the ground that the denial of such exemption would interfere with the securing of a more generous rental from the lessee and would lessen to that extent the amount derived for the school fund and ultimately affect a lessening of the income to be derived in the future from that fund for school maintenance, and that this would interfere with the performance by the State of its governmental function? Can it be said that such a lessee is an instru-
60 mentality necessary to the performance of the governmental function and that a tax upon its income incapacitates it to perform properly the service for which it is employed?

Let us consider for the moment the extent to which the rule insisted upon by petitioner would lead. It can not be questioned that the administration by the State of the permanent school fund secured from the sale or lease of the ceded lands is of no less sovereign character than its administration of the lands themselves in the obtaining of that fund. Under the statutes of Oklahoma this fund is administered by the commissioners of the land office and the income therefrom, which the enabling act provides shall be used for the maintenance of the public schools, is obtained by loaning it on first mortgages on land and by investment in certain specified classes of public lands. If an individual who obtains the use of school lands from the commissioners of the land office for a rental is an instrumentality of the State in the carrying out of its governmental power to maintain public schools, as is claimed, so is the individual who obtains the use of a portion of the school fund for the payment of an interest charge. If the first is exempt from taxation by the Federal Government, we see no reason why the second could not claim the same immunity, thus putting it in the power of any individual or corporation to become a tax exempt governmental

instrumentality of the State of Oklahoma by merely securing a loan from the school fund.

Can it be said that the lessee of school lands stands upon a different footing from others with whom the State deals in carrying out its function of providing public education? His connection with public education is more remote than one who builds a public school under contract with the State and whose total income from the work is paid him directly from school funds, and yet it could not be argued in the light of the decisions cited that the latter was a tax-exempt instrumentality of the State. New York Trust Co. v. United States, 63 Ct. Cls. 100; James A. Sackley Co. v. United States, U. S. Ct. Cls. (decided April 2, 1928). In American Book Co. v. Shelton, 117 Tenn. 745; 100 S. W. 725, a statute of Tennessee had provided for the use of uniform text books in the public
61 schools and for the creation of a State text book commission which should determine the books to be used and provide for their being supplied to the schools, the commission being empowered to contract with some publishing house, through public aid, for the maintaining of a depot in the State of the books selected from which they would be supplied and fixing the prices at which they might be sold. The plaintiff, as the successful bidder with whom the State contracted through the commission, claimed immunity from State ad valorem or privilege taxation, upon the ground that it was an instrumentality through which the State performed its sovereign function of providing public education. The court in denying it the immunity claimed, said:

If the fact that the book company has a contract with the State gave it immunity from taxation, the same rule would likewise exempt a manufacturer who might sell clothes for the convicts, the stationer who furnishes supplies to the State officers, and the printer who publishes the proceedings of the legislature or the Supreme Court reports, and apply to the ice dealer, who purchases his stock from the board of prison commissioners, to the coal dealer who procures his coal from the State commission, and to the dealer in hosiery who buys the output of the prison factory.

We do not think that petitioner under the facts here proven, as a lessee of public school lands in Oklahoma, for private and individual profit, stands in a position different insofar as liability for Federal income tax is concerned, from a lessee of other property of the State or property of a private individual. We can not see in the taxing by the Federal Government of its income therefrom an interference with the exercise by that State of one of its governmental powers.

The second issue involves the question of whether petitioner is entitled to a paid-in surplus in the amount of $58,538, the alleged value of the improvements on the lease on the date of its acquisition in January, 1914. In advertising for bids for releasing the land in question the commissioners of the land office notified prospective

bidders that the equipment on the land had been appraised at a
62 value of $55,800, that the land contained fifteen producing wells and that the oil production from said wells averaged 8,113 barrels per month from January 1 to November 1, 1913. The testimony establishes that the wells drilled had an aggregate depth of 29,269 feet, the reproductive cost of which amounted to $58,538 in January, 1914. The testimony further establishes that, based upon the estimated production of oil from those wells over the five-year period of the lease and upon the then prevailing price of oil, the present net worth of those improvements in January, 1914, amounted to $58,710. Upon all the facts of record, we are of the opinion that in January, 1914, the improvements, consisting of fifteen producing wells, had an actual cash value of $58,538 which attached to the lease awarded to Sutton, for the lessee acquired a five-year interest in those wells, together with a preference right to release the land for an additional five years. Sutton and his associate paid in to petitioner the physical equipment on the leased land, having an actual cash value of $55,800, and in addition, the lease, having an actual cash value of $58,538, for $25,000 par value of petitioner's stock, $25,000 of its bonds, and its note for $5,800. No evidence has been submitted as to the payment of the said bonds and note but respondent raised no question with respect thereto and has included in petitioner's invested capital the amount of $55,800, representing the cost of the physical equipment to petitioner as aforesaid. The only question presented to the board is whether petitioner is entitled to additional invested capital in the amount of $58,538 as a paid-in surplus. The lease, of the actual cash value of $58,538, having been paid in for stock in addition to other property paid in for the stock issued and of a value equal to the par value thereof, we are of the opinion that petitioner is entitled to include in invested capital the amount of $58,538 as a paid-in surplus under the provisions of section 207 of the revenue act of 1917, and section 326 of the revenue act of 1918.

With reference to the third issue, the value of $58,538 in January, 1914, of the improvements on the lease should be included in the basis upon which respondent computed the allowable deduction for depletion.

The fourth issue is relative to the proration of prior years'
63 taxes out of invested capital for each of the years involved. Such proration should be made upon the basis of the correct amount of taxes due as computed pursuant to this decision and in accordance with the commissioner's regulations.

The last issue is relative to the respondent's reduction of petitioner's invested capital for the year 1918 on account of a tentative tax computed on earnings to date of a dividend paid on November 4, 1918, which action must be held erroneous under authority of L. S. Ayers & Co., 1 B. T. A. 1185.

Reviewed by the board.

Judgment will be entered pursuant to rule 50.

GRAHAM, dissenting: The petitioner herein has leased certain oil and gas lands from the State of Oklahoma. The lands covered by

the lease were part of the lands which were conveyed by Congress to the State of Oklahoma at the time of its admission to statehood, and the restrictions which were attached to this land by the terms of the enabling act were accepted by the State of Oklahoma in its constitution and subsequently the legislature of the State passed such legislation as was necessary to carry out the terms imposed by Congress. These lands are conveniently described as school lands. The major question in this proceeding is the right of the Federal Government to impose a tax upon the income derived by this petitioner from its operation of its leases on these State-owned school lands.

That the lands here under consideration are the property of the State of Oklahoma is not questioned. Likewise it appears to be conceded that the erection and maintenance of public schools is an essential governmental function of the State. This could not be otherwise in view of the enabling acts and other legislation under and by virtue of which Oklahoma became a State and the United States conveyed to it the school lands, the income of which is here under consideration. The issue has been narrowed to the sole question of the right to tax the income derived by a lessee from State-owned school lands.

The leading case on the right of a State to tax the income of a lessee of Federal lands is Gillespie v. State of Oklahoma, 257 U. S. 501. In holding that such income could not be taxed the United States Supreme Court said:

> *A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.* 240 U. S. 530. *The steps from this to the invalidity of the tax upon income from the leases is not long.*

In cases where the principal is absolutely immune from interference, and injury is allowed into the sources from which net income is derived, and if a part of it comes from such a source, the tax is pro tanto void (Pollock *v.* Farmers Loan & Trust Co., 157 U. S. 429)—a rule lately illustrated by Evans *v.* Gore, 253 U. S. 245, and applied in a case somewhat like the present by the Supreme Court of Hawaii (Oahu Ry. & Land Co. *v.* Pratt, 14 Haw. 126.) Whether this property could be taxed in any other form or not, it can not be reached as profits or income from leases such as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases; and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards. (Italics supplied.)

This case is the converse of the Gillespie case. There the State sought to tax income derived by the lessee of Federal lands. Here the United States seek to tax the income derived by the lessee of State lands.

It is also the law that the United States may not tax the agencies, instrumentalities or property of the States. In Van Brocklin v. State of Tennessee, 117 U. S. 151, the court said:

In Collector v. Day, 11 Wall. 113, it was adjudged that Congress had no power, even by an act taxing all income, to levy a tax upon the salaries of judicial officers of a State, for reasons similar to those on which it had been held in Dobbins v. Erie County Commissioners, 16 Pet. 435, that a State could not tax the salaries of officers of the United States. Mr. Justice Nelson, in delivering judgment, said: "The General Government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former, in its proportionate sphere, is supreme; but the States, within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the General Government as that Government within its sphere is independent of the States." 11 Wall. 124.

The reasons for exempting all the property and income of a State, or of a municipal corporation, which is a political division of the State, from Federal taxation, equally require the exempting of all the property and income of the National Government from State taxation.

If there were any remaining doubts, the court set them at rest in Pollock v. Farmers Loan & Trust Co., 157 U. S. 584, when it said:

As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the INSTRUMENTALITIES OR THE PROPERTY of a State.

The United States have such powers and right as have been granted to them by the several States. There is nothing in the Constitution which limits the right of either to tax the other. That these limitations exist is, however, beyond question. They grew out of the common necessity that each, within its own sphere, be free from interference from the other. I have been unable to find any intimation that the limitations are more rigorous in the case of one than in the case of the other.

If, then, as was held in the Gillespie case, the State may not tax the income derived by the lessee from the operation of lands leased from an instrumentality of the United States, it follows inevitably that the United States may not tax the income derived by a lessee from the operations of lands leased from the State of Oklahoma or one of its instrumentalities. The effect upon the lessor, of taxing the income of the lessee, is the same irrespective of which is the lessor and the same rule should be applied to either case. The income derived by a lessee on public school lands of the State of Oklahoma is not, in my opinion, subject to Federal taxation.

Marquette, Phillips, and Seifkin agree with this dissent.

Now, December 9, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503.

CORONADO OIL & GAS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

The above-entitled action came on for hearing on May 13, 1929, upon motion made on behalf of the respondent for settlement of deficiencies. W. F. Gibbs, Esq., appeared for 'tioner, although it appeared that counsel for the petitioner had had due notice of this motion and hearing. It further appearing that the proposed recomputation of deficiencies submitted by the respondent in support of his said motion is in accord with the findings of fact and conclusions of law promulgated January 14, 1929.

Now, therefore, upon consideration of said motion and proposed recomputation and upon all the record and files of this action, it is ordered, adjudged, and determined that the deficiencies in income and profits taxes for the several years involved are as follows:
67 for the calendar year 1917, $967.63; for the calendar year 1918, $5,942.37, and for the calendar year 1919, $808.43.

Enter.

(Signed) S. L. TRUSSELL,
Member United States Board of Tax Appeals.

SLT/dsm.

Entered May 14, 1929.

A true copy. Teste:

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

WASHINGTON, D. C., —— —, ——.

Now, December 9, 1929, the foregoing decision certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Stipulation of venue

Filed Oct. 30, 1929

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the decision and judgment of the United States Board of Tax Appeals in the above entitled cause, rendered on May 13, 1929, and entered on May 14, 1929, may be reviewed by the Court of Appeals of the District of
68 Columbia. This agreement is made under and pursuant to the provisions of Section 1003 of the Revenue Act of 1926.

Dated this 29 day of October, 1929.

(Sgd.) S. W. HAYES,
Attorney for Petitioner.

(Sgd.) C. M. CHARRET,
Attorney for Respondent.

Of counsel:

D. A. RICHARDSON,
1112 Colcord Bldg., Oklahoma City, Okla.

HUBERT L. BOLEN,
307 Tradesmen's Nat'l Bank Bldg.,
Oklahoma City, Okla.

T. P. GORE,
1040 Woodward Building, Washington, D. C.

Now, December 9, 1929, the foregoing stipulation certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Notice

Filed Oct. 30, 1929

To C. M. CHARRET, Esq.,
General Counsel, Bureau of Internal Revenue,
Washington, D. C.,
Attorney for Respondent.

SIR: Please take notice that on the 30th day of October, 1929, the undersigned will present to the United States Board of Tax Appeals, and file with the clerk thereof, the petition of the Coronado Oil and

Gas Company, a copy of which is annexed hereto, for the review by the Court of Appeals of the District of Columbia of the final order and decision of the United States Board of Tax Appeals in the above entitled proceeding, rendered on May 13, 1929, and entered upon the records of said Board of Tax Appeals on May 14, 1929.

Dated at Washington, D. C., October 29th, 1929.

(Sgd.) S. W. Hayes,
T. P. Gore,
Attorneys for Coronado Oil and Gas Company.

Of counsel:
D. A. Richardson,
1118 Colcord Bldg., Oklahoma City, Okla.
Hubert L. Bozeman,
307 Tradesmen's Natl. Bank Bldg., Oklahoma City, Okla.
T. P. Gore,
1040 Woodward Building, Washington, D. C.

Service of copy of the within and foregoing notice, with attached thereto copy of petition for review referred to therein is hereby accepted this 30th day of October, 1929.

(Sgd.) C. M. Charest,
General Counsel, Bureau of Internal Revenue and Attorney for Respondent.

Before United States Board of Tax Appeals

[Title omitted.]

Petition for Review

Filed Oct. 30, 1929

To the Honorable the Chief Justice and the Associate Justices of the Court of Appeals of the District of Columbia:

Your petitioner is aggrieved by decision and judgment or order of the United States Board of Tax Appeals, rendered against it on May 13, 1929, and entered on May 14, 1929, in the case of Coronado Oil and Gas Company, petitioner, vs. Commissioner of Internal Revenue, respondent, No. 10,503, on the docket of the United States Board of Tax Appeals.

Nature of the case

(1) The petitioner is a corporation, organized and existing under the laws of the State of Oklahoma, with its office at Cleveland, Oklahoma, and is engaged in the business of exploring for, developing, and mining petroleum oil and gas and selling the same.

(2) The petitioner's entire income for the calendar years 1917, 1918, and 1919, was derived by it from the sale of crude petroleum,

produced and mined by it from certain common school lands owned by the State of Oklahoma, under oil and gas leases executed to the petitioner for the purpose of exploring, developing, and operating said school lands for production of crude petroleum oil and gas.

(3) The lands covered and included in said oil and gas mining leases from which petitioner produced during the years 1917, 1918, and 1919, all the petroleum and oil from the sales of which it derived and received all its income during said years were granted to the State of Oklahoma by an act of Congress approved June 6, 1906, entitled, "An Act to enable the people of Oklahoma and of the Indian Territory to form a constitution and State government and be admitted into the Union on equal footing with the original States; and to enable the people of New Mexico and of Arizona to form a constitution and State government and be admitted into the Union on an equal footing with the original States." (Chapter 3335, United States Statutes, 1905–1906, part 1, p. 267.)

(4) Section 7 of said act granted to the State of Oklahoma, upon its admission into the Union, sections 16 and 36 in every township in Oklahoma Territory for the use and benefit of the common schools of the State.

(5) Section 8 of the same act provided that where any of said lands granted to the State are valuable for minerals, including gas and oil, such lands shall not be sold by the State prior to
71 January 1, 1915, but that the same may be leased for periods not exceeding five (5) years by the proper officers of the State, and that all proceeds from such leases shall be converted into the fund to which they shall properly belong and that no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing.

(6) The leases from which the income of petitioner was derived during said years covered and included the south half (S. ½) of the northwest quarter (NW. ¼), the southwest quarter (SW. ¼), the northeast quarter (NE. ¼), and the south half (S. ½) of the southeast quarter (SE. ¼) of section sixteen (16), township twenty-one (21) north, range eight (8) east of the Indian meridian.

(7) The statutes of Oklahoma, which authorized the commissioners of the land office of the State of Oklahoma to lease said lands for oil and gas purposes, provided that such lease should be made subject to the rules and regulations of the commissioners of the general land office, and said leases to the petitioner provided by their terms that said leases shall in all respects be subject to the rules and regulations theretofore or thereafter lawfully prescribed by the commissioners of the land office of the State of Oklahoma, relative to oil and gas leases on public lands, not in conflict with the lawful terms of the lease, and that neither said leases nor any interest therein should be sublet, assigned, or transferred without the consent of the commissioners of the land office first obtained in writing; and

(8) The rules and regulations of the commissioners of the land office of Oklahoma, under which said leases were made to the petitioner, and the provisions of said leases, required that petitioner should give a bond to the State of Oklahoma in substance that it, as lessee, would faithfully perform the terms and conditions of the lease, and said bonds were given by the petitioner.

(9) One of said leases provided and required that the petitioner, as lessee therein, should pay to the State of Oklahoma a royalty of fifty (50%) per cent of all the oil and gas produced under said lease, and the other of said leases provided for the payment to the State as a royalty one-eighth (⅛) part of the oil and gas produced from the premises covered by such leases.

(10) The Commissioner of Internal Revenue determined that the income derived and received by petitioner from the sale of petroleum oil mined by it from aforesaid common school lands owned by the State of Oklahoma under said oil and gas mining leases, during the years 1917, 1918, and 1919, was subject to Federal income and profits taxes for said years. From this decision of the Commissioner of Internal Revenue the taxpayer appealed to the United States Board of Tax Appeals.

(11) Said appeal was submitted to the United States Board of Tax Appeals upon petitioner's petition, as amended, the commissioner's answer thereto, evidence introduced at a hearing thereon, oral argument by counsel and printed briefs; and the Board of Tax Appeals on May 13, 1929, rendered its decision which was, on May 14, 1929, entered, by which the United States Board of Tax Appeals decided, ordered, and adjudged that there were deficiencies in the income and profits taxes of the petitioner for the several years involved as follows:

For the calendar year 1917	$967.63
For the calendar year 1918	5,942.37
For the calendar year 1919	308.43

For the foregoing reasons, and upon the assignments of error hereinafter made, the petitioner files this its petition for review by this honorable court.

Court of review

A review of the aforesaid decision of the United States Board of Tax Appeals in the above entitled proceeding is sought by the Court of Appeals of the District Court of Columbia and the parties to said proceeding have agreed, as evidenced by stipulation filed with the clerk of the United States Board of Tax Appeals, that said review shall be in this court.

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Assignments of error

As grounds of review of said decision and as reasons why said decision should be reversed by this court, your petitioner believes and avers that errors were committed by the United States Board of Tax Appeals to its damage and prejudice as follows:

(1) That the United States Board of Tax Appeals erred in determining, deciding, and adjudging that the net income derived by petitioner from the sale of petroleum oil produced by it from the aforesaid common school lands owned by the State of Oklahoma, under oil and gas mining leases duly made to petitioner for oil and gas mining purposes, is subject to Federal income and profits taxes.

(2) That the United States Board of Tax Appeals erred in refusing to hold that the provisions of the revenue act of 1916, as amended by the revenue act of 1917, as amended by the revenue act of 1918, insofar and to the extent that said acts respectively authorize and direct, or attempt to authorize and direct, the assessment and levy against the collection from petitioner of income and excess profits taxes upon or because of the net income derived by petitioner during the years 1917, 1918, and 1919, from the sale of petroleum oil produced by it from the aforesaid common school lands owned by the State of Oklahoma, under oil and gas mining leases duly made to the petitioner for oil and gas mining purposes, are unconstitutional and void and without the power of the Congress of the United States to enact.

(3) That the United States Board of Tax Appeals erred in holding that there were deficiencies in income and excess profits taxes of the petitioner for the years 1917, 1918, and 1919, in the amounts of $967.63, $5,942.37, and $308.43, respectively, or in any amounts.

Wherefore your petitioner prays that the decision of the Board of Tax Appeals entered herein against it be reviewed and
74 reversed by this honorable court, and for such other and further relief as this honorable court may deem meet and proper in the premises.

CORONADO OIL AND GAS COMPANY,
By S. W. HAYES,
T. P. GORE,
Attorney of Record, 1112 Colcord Building, Oklahoma City, Oklahoma.

Of counsel:

D. A. RICHARDSON,
1112 Colcord Building, Oklahoma City, Okla.
HUBERT L. BOLEN,
307 Tradesmen's National Bank Bldg., Oklahoma City, Okla.
T. P. GORE,
1040 Woodward Building, Washington, D. C.

STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me, the subscriber, a notary public in and for the county and State aforesaid, S. W. Hayes, who, upon being duly sworn, according to law, does depose and say that he is attorney of record of Coronado Oil and Gas Company, the peti-

tioner above named, and that as such he had authority to and did sign the foregoing petition; that he has read the same and that to the best of his knowledge and belief the facts set forth therein are true, that the assignments of error are well taken and that said petition is filed in good faith.

S. W. HAYES.

Subscribed and sworn to before me this the 22 day of October, 1929.

[Seal of Helen D. Brimi, notary public, State of Oklahoma.]

HELEN D. BRIMI,
Notary Public.

My commission expires October 15, 1933.

Now, December 9, 1929, the foregoing petition for review, notice of filing and proof of service certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

75 Before United States Board of Tax Appeals

Docket No. 10503

IN THE MATTER OF CORONADO OIL & GAS COMPANY, PETITIONER

VS.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Statement of evidence

Lodged 11-19-29. Filed Dec. 5, 1929.

Caption

The above-entitled cause came on for hearing before Honorable William R. Green, jr., member of the United States Board of Tax Appeals, on the 3rd day of February, 1927, there being present the petitioner, by its counsel, Hubert L. Bolen, J. P. Alkire, and S. W. Hayes, and the respondent by his counsel, Dwight H. Green and Maxwell E. McDowell. Prior to the introduction of testimony the following colloquy took place:

Mr. DWIGHT W. GREEN. If your honor pleases, this case does not stand at issue at the present time. The situation is this: An amended petition has been filed by the petitioner and no answer has ever been entered by the commissioner, and I ask leave at this time to enter a general denial for the commissioner to the allegations of fact set forth in the amended petition.

Mr. GREEN. I take it there is no objection to that?

Mr. Bolen. None whatever.

Mr. Green. Very well. The commissioner's answer by way of general denial will be treated as having been made in the record. You may make your opening statement.

Mr. Bolen. This is a deficiency tax for the years 1917, '18, and '19, the petitioner claiming that there was no—that the commissioner allowed no expenses on invested capital for the cost of drilling wells, and so forth, on the lease. The lease was acquired at first by Dr. Sutton and afterwards transferred to the Coronado Oil and Gas Company and the further question in the case is that this is
76 State-owned school land and that the lease or the income derived from the lease on such school land is not taxable by the Federal Government for income taxes.

Other colloquy occurred relative to the first issue stated by Mr. Bolen above, but, since that issue will not be presented on appeal, it is omitted.

Whereupon the petitioner maintaining the issues on its behalf introduced the following testimony:

W. A. Durant, being first duly sworn, in substance testified:

I reside at Oklahoma City and hold the office of secretary to the commissioner of the land office. The commissioner of the land office is charged with the duty of leasing the school lands and public lands of the State for agricultural and mineral purposes. The secretary of the commissioner of the land office is custodian of all the documents and records pertaining to all the acts of the commissioners of the land office in leasing school lands and other public lands of the State.

Witness then identified a book as the record of *of* the minutes of the commissioner of the land office kept by the State of Oklahoma, and a portion thereof as being the minutes of a meeting of the commissioners of the land office held on September 18, 1918. Whereupon there was introduced in evidence by petitioner a portion of said minutes, as follows:

"In re appointment of appraisers to appraise oil and gas improvements it was moved and seconded that Frank Orr be selected and designated as appraiser on behalf of the State for the purpose of appraising improvements and other necessary appliances used in connection with the operation of any producing wells on the south half of the northwest quarter, and the southwest quarter, and the northeast quarter, and the south half of the southeast quarter of section 16, township 21, range 8 east of Indian meridian, at their fair and reasonable value. All voted aye: Motion prevailed."

Thereupon the witness Durant identified a record of the min-
77 utes of the meeting of the commissioners of the school land office held on December 4th, 1918, and the witness testified: These minutes contain action on notice to be given by the commissioners of the land office of the State for bids for leasing the northeast quarter and the south half of the northwest quarter and the southwest quarter, and the south half of the southeast quarter of

section 16, township 21 north, range 8 east, Indian meridian for oil and gas purposes. Said notice of bids was introduced in evidence by petitioner and is as follows:

Offer in evidence

Notice of receiving bids for leasing State and school lands for oil and gas purposes

Notice is hereby given that the commissioners of the land office of the State of Oklahoma will receive sealed bids at the office of the secretary, fifth floor Mercantile Building, Oklahoma City, Oklahoma, at four o'clock p. m., on the 7th day of January, 1914, to be opened immediately thereafter in the presence of the bidders, for the re-leasing of the following described public lands belonging to the State of Oklahoma, to-wit:

Northeast quarter, and south half of the northwest quarter, and southwest quarter, and south half of southeast quarter, all in section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty (480) acres.

Said lands to be leased for oil and gas purposes is for a term of five years with preference right to re-lease for an additional period of five years under and within the terms of the laws of Oklahoma and the rules and regulations of the commissioners of the land office at a royalty of fifty (50%) per cent of the total output of all oil and gas from said lands, and in addition thereto such bonus as may be offered therefore.

All bids must be on forms furnished by the commissioners of the land office, and each bid must be accompanied by a certified check or bank draft on some bank within the State of Oklahoma for the sum of three thousand ($3,000.00) dollars, payable to the commissioners of the land office of the State of Oklahoma, said sum being deposited as earnest money. All deposits accompanying rejected bids will be returned to such bidders as soon thereafter as practicable. But in the event that any successful and accepted
76 bidder shall fail or refuse to comply with the terms and conditions of said bid, such deposit by him shall be forfeited thereby, and shall become the property of the State of Oklahoma, for use and benefit of the proper fund under control of the commissioners of the land office.

Each bidder shall deposit the sum of fifty-five thousand and eight hundred ($55,800.00) dollars in cash, or by bank draft drawn by some bank in the State of Oklahoma, for the improvements located on said land and now used in connection with the oil and gas wells being operated by the Southwestern Oil Fields Company, said improvements having been duly appraised, and the value of same fixed in the above amount, as provided by law and the rules and regulations of the commissioners of the land office; said sum of money to be paid over to the Southwestern Oil Fields Company, a corporation,

in the event it elects not to take a lease on said land at the highest and best bid received, as determined by the commissioners of the land office.

The terms and conditions of said lease to be executed shall conform to and be governed by and be interpreted and construed by the laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office.

The above described lands have fifteen wells thereon producing oil at this time. The total gross production therefrom for the month of October, 1913, was seven thousand two hundred and seventy-five (7,275) barrels of oil. The total oil production from said lands from January 1st to November 1st, 1913, was eighty-one thousand one hundred and thirty-eight (81,138) barrels. The average production for the ten months being eight thousand one hundred and thirteen (8,113) barrels per month.

For further information as to production, improvements, and form of bid, and rules for bidding, address John R. Williams, Secretary, Oklahoma City, Oklahoma.

Dated this 4th day of December, 1913.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

JOHN R. WILLIAMS,
Secretary.

79 The witness Durant thereupon identified a record of the minutes of the commissioners of the land office, adopting rules and regulations for leasing public lands for oil and gas purposes covering aforesaid lands, which rules and regulations were introduced in evidence by petitioner and are as follows:

Offer in evidence

Rules and regulations for leasing public lands for oil and gas purposes

Bids to be received on the following described lands:

Northeast quarter, and south half of northwest quarter, and southwest quarter, and south half of southeast quarter, all in section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty (480) acres.

Rule 1. All bids must be on forms furnished by the commissioners of the land office, and must be filed with the secretary at four o'clock p. m., on the 9th day of January, 1914, to be opened immediately thereafter.

Rule 2. All bidders will be required to deposit a certified check or bank draft on some bank within the State, for the sum of three thousand ($3,000.00) dollars, payable to the commissioners of the land office to be held as earnest money as outlined in the advertisement.

Rule 3. The highest responsible bidder will be required to give bond, to be approved by the commissioners of the land office for the faithful performance of his contract, and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay.

Rule 4. The royalty shall be fifty (50%) per centum of the total output of oil and gas from said lands, and all bonuses must be offered in addition to the fixed royalty. Should bonus be offered in cash, the same must be paid to the commissioners at the time of the execution of the lease, and if in oil, the bidder must offer a definite and specific percentage of the gross production in addition to the fixed royalty of fifty (50%) per cent above set out.

Rule 5. All producing wells that are now or may hereafter be drilled on adjoining properties to be offset by corresponding wells on the lands to be leased under these rules.

Rule 6. Certified copies of pipe line runs, and all sales and shipments to be furnished monthly, or on demand.

Rule 7. Accurate and reliable information concerning wells and their operation and management to be furnished on demand to the commissioners of the land office, or any one authorized to act for them.

Rule 8. The lease to conform to and be interpreted and construed by the laws of the State of Oklahoma, and the rules of the commissioners of the land office.

Rule 9. The Southwestern Oil Fields Company, a corporation, by virtue of its lease heretofore held upon said lands, under the law, is entitled to the preference right to re-lease said land at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, said preference right to take at the highest and best bid to be exercised within five (5) days after the award by the commissioners of the land office.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

JOHN R. WILLIAMS,
Secretary.

Thereupon was introduced in evidence by the petitioner that portion of the minutes of a meeting of the commissioners of the State school land office of date December 4, 1913, which reflects the action of the board of commissioners of the land office on aforesaid motions and regulations, which is as follows:

Offers in evidence

It was moved and seconded that the above notice of receiving bids, rules, and regulations and form of bid, be and the same are hereby adopted and approved. All vote aye: Motion prevailed.

Mr. Michaelson, attorney for the Southwestern Oil Fields Company, and the members of the board discussed the matter of royalty to the State to be paid by said company from the production of oil and gas from the above described lands from the 14th day of November, 1913, the date on which the lease of the Southwestern Oil Fields Company's lease expires, to the date when the land will be re-leased under the notice of advertisement herein adopted, without reaching an agreement.

81 It was moved and seconded that if the Southwestern Oil Fields Company does not enter into an agreement for the operation of the lease from the expiration of its lease to the date the same is released under the above advertisement, at a royalty for which the same is re-leased for the second term of five years, then, in that event, that a receiver be asked for to operate and handle said property.

All vote aye: Motion prevailed.

Thereupon, Mr. Michaelson requested time in which to consult his company relative to the matter, and same was agreed to not to exceed ten days time from this date.

Witness Durant thereupon turned to and identified the minutes of the meeting of the commissioners of the land office held on January 12, 1914, and testified:

These minutes reflect the bids for oil and gas leases on the tracts of land I have heretofore been asked about and show bids to have been made by the Southwestern Oil Fields Company and by George W. Sutton.

Thereupon is introduced in evidence by petitioner a portion of aforesaid minutes of the said meeting of the commissioners of the land office on January 12, 1914, as follows:

Mr. Bryan, on behalf of the oil and gas committee, presents the following report, to wit:

OKLAHOMA CITY, OKLAHOMA, *January 9, 1914.*

COMMISSIONERS OF THE LAND OFFICE,
State of Oklahoma.

GENTLEMEN: We, your oil & gas committee, beg leave to submit the following report, to wit:

On January 9, 1914, at four o'clock p. m., we received and opened bids for the re-leasing of the northeast quarter, and south half of northwest quarter, and southwest quarter, and south half of southeast quarter of section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty acres,

82 more or less, in accordance with the published advertisement and rules and regulations governing the same, as follows:

Bid for leasing public school lands

To the Commissioners of the Land Office of the State of Oklahoma.

GENTLEMEN: Application is hereby made to lease for oil and gas purposes, under the laws of the State of Oklahoma, and the rules

and regulations lawfully made by the commissioners of the land office, the following described lands in Pawnee County, Oklahoma, to wit:

Northeast quarter (NE. ¼), and south half (S. ½) of northwest quarter (NW. ¼), and southwest quarter (SW. ¼), and south half (S. ½) of the southeast quarter (SE. ¼) of section sixteen, township twenty-one (21) north, range eight (8) east, containing four hundred and eighty acres (480), more or less.

Your applicant being the present owner and in possession of the improvements and equipment on the above described land, draft for fifty-five thousand eight hundred ($55,800.00) dollars, the appraised valuation of said improvements, does not accompany this bid.

Draft number 43419 in the sum of three thousand ($3,000.00) dollars, issued by the Bartlesville National Bank of Bartlesville, Oklahoma, is herewith deposited with this bid, as earnest money, and made payable to the commissioners of the land office, under the terms of the advertisement.

Your applicant hereby bids for said oil and gas mining lease, a royalty of twelve and one-half per cent (12½) and a bonus in addition thereto in the sum of fifteen thousand ($15,000.00) dollars.

This bid is made under the express condition that the bidder does not in any manner waive its preference right given it under its lease covering the above described land, and by law to take said lease as advertised at the highest bid therefor if it so elects.

83 Dated at Bartlesville, Oklahoma, this 9th day of January, 1914.

(Signed) SOUTHWESTERN OIL FIELDS COMPANY,
By C. H. MCCREADY,
General Manager.

Form of bid for leasing public lands

To the COMMISSIONERS OF THE LAND OFFICE,
State of Oklahoma.

GENTLEMEN: Having read the foregoing rules and regulations for leasing public lands for oil and gas purposes, application is hereby made to lease under the laws of Oklahoma and the rules and regulations of the commissioners of the land office, the following described lands:

The south half of the northwest quarter (S. ½ of NW. ¼), the southwest quarter, the northeast quarter, and the south half of the southeast quarter (S. ½ of SE. ¼) of section 16, township 21 north, range 8 east, in Pawnee County, Oklahoma.

Draft number 527, in the sum of fifty-five thousand eight hundred ($55,800.00) dollars, on the State National Bank of Oklahoma City, Oklahoma, in the State of Oklahoma, accompanies this bid, and is made payable to the commissioners of the land office and deposited

under the rules and the published advertisement, and in the event that the lease is awarded and executed to the bidder hereunder, this draft is to be used for the purposes of paying for the improvements now on the above described lands, and belonging to the Southwestern Oil Fields Company, and appraised at the said sum of fifty-five thousand eight hundred ($55,800.00) dollars.

Certified check in the sum of three thousand ($3,000.00) dollars, issued by the First National Bank of Cleveland, Oklahoma, accompanies this bid, and is deposited as earnest money, and made payable to the commissioners of the land office, under the terms of the advertisement, and the rules of the commissioners.

In addition to the fifty per centum royalty determined and
84 fixed by the commissioners of the land office I agree to pay a bonus of no per cent of the gross production of oil produced on said lease, or — ($no) dollars.

In addition to the fifty per centum royalty determined and fixed by the commissioners of the land office I agree to pay a bonus of no per cent of the gross production of gas produced on said lease, or — ($no) dollars.

(Signed) GEORGE W. SUTTON,
Cleveland, Oklahoma.

And your committee herewith tenders the original bids to the commissioner of the land office for their consideration, with recommendation.

Respectfully submitted.

(Signed) G. T. BRYAN.

After carefully considering the two bids received, it was moved and seconded that George W. Sutton be declared the highest responsible bidder, and that his bid be declared the highest and best bid received, and that he be awarded a lease upon the above-described land for a period of five years, under the law, rules, and regulations governing the same, in accordance with the bid submitted by him, provided the Southwestern Oil Fields Company, a corporation, elects not to take a lease upon said land at the royalty agreed to be paid by the said George W. Sutton, as set out in his bid, as provided in rule 9 of the rules and regulations promulgated for the leasing of said land.

Provided further, that if the Southwestern Oil Fields Company, a corporation, in the exercise of its preference right takes same at the high bid so received, then in that event a lease be awarded to said company for a second period of five years, as provided by law and the rules and regulations in such case made and provided.

All vote aye: Motion prevailed.

Thereupon the witness Durant identified the record of the minutes of the proceedings of the commissioners of the land office at a meeting held January 16, 1914, of which minutes of the actions of the commissioners of the land office at said meeting the following part was introduced in evidence by the petitioner:

85 The secretary reported that the Southwestern Oil Fields Company, in the exercise of their preference right, elected not to take a lease for the second term of five years upon the award recently made to G. W. Sutton of Cleveland, Oklahoma, upon the following described land:

Northeast quarter, (NE. ¼), and south half of northwest quarter (S. ½ of NW. ¼), and southwest quarter (SW. ¼) and south half of southeast quarter (S. ½ of SE. ¼), all in section 16, township 21 north, range 8 east, Indian meridian.

And thereupon after possession of the lease and improvements had been delivered to Mr. Sutton, the amount deposited in the sum of fifty-five thousand eight hundred ($55,800.00) dollars for improvements, was paid over to the Southwestern Oil Fields Company.

It was moved and seconded that the action of the secretary be confirmed and approved, and that the chairman and secretary be authorized to enter into a lease contract with G. W. Sutton for a term of five years, as provided by law, and the rules and regulations governing the recent bidding, and that his bond be fixed at ten thousand ($10,000.00) dollars, same to be surety company bond.

All vote aye: Motion prevailed.

At the request of Dr. G. W. Sutton, it was moved and seconded that the lease awarded to him on the northeast quarter (NE. ¼), and south half of northwest quarter (S. ½ of NW. ¼), and southwest quarter (SW. ¼), and south half of southeast (S. ½ of SE. ¼) in section 16, township 21 north, range 8 east, Indian meridian, be made to Coronado Oil and Gas Company.

All vote aye: Motion prevailed.

Thereupon the witness Durant testified: As secretary of the commissioners of the land office I have in my custody the lease which was executed pursuant to the foregoing action of the commissioners of the land office and the lease which I hold was executed by the commissioners of the land office to the Coronado Oil and Gas Company on the south half of the northwest quarter (S. ½ of NW. ¼), the southwest quarter (SW. ¼), and the northeast quarter (NE.
86 ¼), and the south half of the southeast quarter (S. ½ of SE. ¼) of section 16, township 21 north, range 8 east, Indian meridian, as of date of January 17, 1917.

Said lease was thereupon offered and introduced in evidence by petitioner and is as follows:

Offer in evidence

Oil and gas mining lease

This indenture of lease, made and entered into in duplicate on this 17th day of January, 1914, by and between the commissioners of the land office of the State of Oklahoma, hereinafter styled the lessors, parties of the first part, and Coronado Oil and Gas Company, hereinafter styled the lessee, party of the second part,

Witnesseth: That under and in pursuance of the constitution and laws of the State of Oklahoma, the said lessors, for and in consideration of the royalty, covenants, and stipulations and conditions herein expressed and hereby agreed to be paid, observed, and performed by the said lessee, its successors and assigns, do hereby lease and let unto the said lessee and its successors and assigns for a term of five (5) years from and after the date hereof all oil deposits and natural gas in or under the following described tract of land lying in the county of Pawnee, in the State of Oklahoma, to wit:

The south half of the northwest quarter, the southwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one (21) north, range eight (8) east I. M.

Which said lands are public lands belonging to the State, and were by the said commissioners of the land office declared to be valuable for oil and gas purposes, and the said oil and gas deposits therein contained were by the said commissioners of the land office segregated from the surface use and interest therein, with the right to prospect for, extract, pipe, store, refine, and remove such oil and natural gas, with the right to use and keep so much of the said surface of said premises as may be necessary to prosect for, extract, pipe, store, refine, and remove such oil and natural gas, including still further the right to use a sufficient amount of such oil and natural gas as fuel, light, and power so far as may be neces-

87 sary to the prosecution of said operations, and with the further right to use any water on said premises that may be necessary to carry on said operations, in consideration whereof the lessee hereby agrees to pay a royalty of fifty (50%) per centum of all the oil and gas produced and sold from the fifteen wells now in operation upon the said premises, and to operate the same to their full capacity, and not to abandon or plug any well now upon the said lands without written consent of the commissioners of the land office first obtained in writing.

All oil and gas due to the State under this contract shall be delivered by the lessee herein or his assigns free of cost to the State into pipe lines, tanks, or cars, or settled for before removing the same from the premises if sold in any other way. Certified copies of gauge tickets, sales, and shipments to be furnished at the request of the commissioners or any one authorized to act for them; gas to be metered on the premises under high pressure unless some other method of gauging and measuring same shall be hereafter agreed upon in writing.

The lessee further covenants and agrees to exercise diligence in the sinking of wells for oil and gas purposes on the lands covered by this lease, and to drill a sufficient number of wells on said premises to offset each and every well drilled upon adjoining premises, and the said lessee is hereby required and binds itself to develop said premises as is required by the laws of the State of Oklahoma,

and the rules and regulations adopted by the commissioners of the land office.

Whenever any well shall hereafter be drilled adjoining said premises and such well shall produce oil or gas in paying quantities, then within fifteen days thereafter the lessee herein shall begin the drilling of offset wells as above provided and development of oil and gas on such land herein shall be sufficient to extract all oil and gas therefrom with the least possible delay.

The said lessee shall operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such lands are located, and the failure to do so shall forfeit this lease to the State, and thereupon the commissioners of the land office shall be entitled to take immediate possession of said lands and all improvements thereon. Accurate and reliable information concerning all wells and their operation and management to be furnished on demand of the commissioners of the land office. The said party of the second part further agrees to carry on operations in a workmanlike manner to the fullest possible extent; to commit no avoidable waste on the said land, and to suffer no avoidable waste to be committed upon the portion of its occupancy or use; to take good care of the same, and to promptly surrender and return the premises upon the termination of this lease.

The tools, boilers, power houses, lines, pumping, and drilling outfits, tanks, engines and machinery (and casing of all dry and exhausted wells) shall remain in the property of the party of the second part, and may be removed by them at any time before or at the expiration of this lease.

The casing, derricks, boilers, power houses, power plants, lines, tanks, tubing, rods, pumping and drilling outfits, engines and machinery, tools and all other appliances necessary to be used in the operation of any producing well on the lease, shall be appraised six months prior to the expiration of this lease contract, in order to ascertain the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office, and one by the lessee herein named or its assignee holding said lease at the time, and if said appraisers be unable to agree upon the fair and reasonable value of all such property of the lessee or its assigns on said premises the two appraisers so appointed shall have the right and authority to appoint a third person, and the appraisement of a majority of said three appraisers shall be binding upon both parties hereto. It being expressly understood that the actual sale value of the materials and improvements mentioned at the time of appraisement shall alone be considered and no expense incurred in drilling, except materials permanently used in the operation of the well, shall be considered as improvements.

In advertising said land for re-lease for a second term of five years, the appraised values of said property of the lessee on the

lease shall be stated in said advertisement, and any bidder
89 other than the lessee herein named or its assignee shall be required to deposit the appraised value thereof with the commissioners of the land office at the time the bid for the second term of five years is made, and if the lessee herein named or its assignee does not succeed in leasing said premises for a second period of five years, then in that event said amount shall be paid over to the lessee herein named or its assignee, provided, however, that all royalties, rentals, charges, and claims have been paid; that it will not permit any nuisance to be maintained on the premises under its control; that it will not use such premises for any other purpose than those authorized in this lease. Said second party further obligates itself and agrees not to plug, abandon, or pull the casing from any well, productive or otherwise, without first securing the written consent of the first party, or its duly authorized agent, and it is further mutually agreed that a violation of this provision shall work a forfeiture of this lease at the option of the first party, and that before abandoning any well under said written consent it will securely plug the same so as to effectually shut off all water above and below the oil-bearing horizons according to law.

And the said party of the second part further covenants and agrees that it will keep an accurate account of all oil and gas mining operations, showing the sales, prices, dates of purchase, and the whole amount of oil and gas mined and removed; and all sums due as royalties shall be a lien on all implements, tools, movable machinery and all other personal chattels used in said prospecting and mining operations and upon all the unsold oil obtained from the land herein leased as security for the payment of said royalty. And it is mutually understood and agreed that this indenture of lease shall in all respects be subject to the rules and regulations heretofore or that may hereafter be lawfully prescribed and not in conflict with the lawful terms of this lease by said commissioners relative to oil and gas leases of public lands, and that this lease or any interest therein shall not be sublet, assigned or transferred without the consent of the commissioners of the land office first obtained in writing. And it is further mutually understood and agreed that this lease is not executed to or in the interest of any
90 pipe line or transportation company, or any company allied to or confederated therewith or any subsidiary company thereof, nor any other company, corporation, person, or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative, or employee, acting singly or as a firm, or corporation of such companies or either of them, and that should the second party or its assigns violate any of the covenants, stipulations, or provisions of this lease, or any of the regulations, or fail for a period of sixty days to pay the stipulated royalties provided herein, then the commissioners, after ten days notice to the parties hereto, shall have the right to avoid this indenture of lease and cancel the same.

If the lessee makes reasonable and bona fide efforts to find and produce oil in paying quantities as herein required of it, and such effort is unsuccessful, it may at any time thereafter surrender and wholly terminate this lease upon the full payment and performance of all its then accrued and payable obligations hereunder.

It is agreed that for any refinery of crude oil and its products and by-products owned and controlled by the State of Oklahoma the State shall have the preference right to purchase and receive the output from said premises at the market prices therefor; providing that the lessee may sell the said output to any firm, corporation, or person whatsoever until notice in writing from the commissioners of the land office has been served upon the lessee that the State of Oklahoma is ready to take such oil or gas or either of them.

The lessee, its successors, or assigns, shall have the preference right to re-lease said premises for a second term of five years at the expiration of this lease, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor at the time of such renewal. Said maximum rate shall be determined by such reasonable and lawful regulations as are now or may hereafter be prescribed by the commissioners of the land office or other person or persons authorized thereto by the State of Oklahoma.

The term "Commissioners of the land office of the State" as used in this lease shall include any board, person, or persons who are or may hereafter be authorized by law to act in behalf of the State
91 in the matters relating to the leasing of the public lands of the State of Oklahoma for oil and gas purposes.

It is further agreed and understood that the approval of this lease by the commissioners shall be of no force nor effect unless the party of the second part furnish a bond in the sum of ten thousand dollars ($10,000.00) to the satisfaction of said commissioners, in accordance with the regulations of said commissioners, which shall be deposited and remain on file in the office of the commissioners of the land office of Oklahoma.

And it is agreed that the lessee shall, at the expiration of each quarter after the premises produces oil and gas, or either of them, for the quarter prior to the said report, and whenever said production reports, computed together or singly vary from the sales report, the lessee, upon the proper showing and proof shall be given credit on the production report or reports for the amount of shrinkage.

The said lessee binds and obligates itself to do and perform all of the conditions imposed on it by law and this lease and obligates itself to protect the State of Oklahoma from all damage, loss, charges, and claims of every kind or nature, by reason of a failure to comply in whole or in part with the terms of this lease as herein imposed, this lease and all rights and privileges inuring to the benefit of the said lessee may be forfeited and cancelled, and the said commissioners for and on behalf of the State of Oklahoma shall be entitled to recover from the lessee's bondsmen all rents,

royalties, charges, and claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease.

In witness whereof, the said parties have hereunto subscribed their signatures, the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By LEE CRUCE,
Governor of the State of Oklahoma
and Chairman of said Commissioners.

92 Attest:

[SEAL.] JOHN R. WILLIAMS,
Secretary.

CORONADO OIL AND GAS COMPANY,

(Signed) By G. W. SUTTON, *President.*

Attest:

GEO. REYNOLDS.

STATE OF OKLAHOMA,
Pawnee County, ss:

Before me, W. H. Boles, a notary public within and for said county and State, on this the 23rd day of January, 1914, personally appeared G. W. Sutton, to me known to be the president of Coronado Oil & Gas Company, and acknowledged to me that he executed the above instrument as his free and voluntary act and deed, and as the free and voluntary act and deed of such corporation, for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and official seal, on this the 23rd day of January, 1914.

(Signed) B. H. BOLES,
Notary Public.

[SEAL.]
My commission expires March 10, 1915.

STATE OF OKLAHOMA,
Oklahoma County, ss:

Before me, Frank B. Lucas, a notary public within and for said county and State, on this the 26th day of January, 1914, personally appeared Lee Cruce, to me known to be the person who subscribed the name of the commissioners of the land office of the State of Oklahoma to the foregoing instrument, as its chairman, and acknowledged to me that he executed the same as his free and voluntary act and deed, and as the free and voluntary act and deed of such commissioners of the land office, for the uses and purposes therein set forth.

93 In witness whereof I have hereunto set my hand and official seal, on this the 26th day of January, 1914.

(Signed) FRANK B. LUCAS,
Notary Public.

[SEAL.]
My commission expires January 3rd, 1915.

Thereupon the witness Durant identified a record of the minutes of the actions of the commissioners of the land office at a meeting held on January 16, 1919, to December 30, 1919, a portion of which minutes of a meeting of February 4, 1919, was offered and introduced in evidence as follows:

Offers in evidence

Re oil & Gas: In the matter of the oil and gas lease held by the Coronado Oil and Gas Company, covering the northeast quarter (NE. ¼); south half of northwest quarter (S. ½ of NW. ¼); southwest quarter, and south half of southeast quarter (S. ½ of SE. ¼), section 16, township 21 north, range 8 east, Pawnee County, which lease had expired on January 17, 1919. The appraisement of the physical property on said lease having been heretofore approved by the commissioners of the land office, and the parties holding said lease now asking that the same be advertised at once for re-lease in order that they might offer a bid to obtain a commercial lease thereon and continue to operate said property. After explanations by Mr. R. L. Lunsford, president of the Coronado Oil & Gas Company, and W. A. Durant, special agent oil & gas division, and after discussion by the board, it was moved by Mr. Wilson, and seconded by Mr. Carter that said above described property be and the same is hereby ordered advertised under the preference right for re-lease for oil and gas purposes. Motion prevailed.

The witness Durant thereupon identified a record of the minutes of a meeting of the commissioners of the land office, held on March 18, 1919, of which the following portion was offered and introduced in evidence by petitioner:

Re oil & gas (opening of bids): In the matter of opening
94 bids of oil and gas pursuant to advertisement, as hereinafter set out for the awarding of oil and gas leases, the tracts upon which bids are to be received having been advertised, the sums together with the accompanying descriptions are herebelow set out, which are as follows: (List of lands accompanies each bid.)

Hereupon, it being 3.00 p. m., the hour at which said bids were advertised to be received and opened on public lands set out for oil and gas purposes, it was duly moved and seconded that said bids be received, which motion was unanimously carried, and the bids by the respective bidders were tendered and received, and it appearing that all persons desiring to bid had handed in their bid, announcement being made that the receiving of bids was about to be closed, and no response being made, it was thereupon further moved and seconded that the receiving of bids be and the same is hereby ordered closed.

All vote aye: Motion prevailed.

Bid of the Coronado Oil & Gas Company of Cleveland, Oklahoma, accompanied by a certified check in the sum of one thousand ($1,000.00) dollars on tract No. 2 (as advertised) being the south half of northwest quarter (S. ½ NW. ¼); southwest quarter (SW.

¼); northeast quarter (NE. ¼) and south half of southeast quarter (S. ½ SE. ¼) of section 16, township 21 north, range 8 east, Indian meridian, Pawnee County, Oklahoma, bonus offered being four hundred and eighty ($480.00) dollars, or one dollar ($1.00) per acre.

Bid of the Uncle Sam Oil Company, of Kansas City, Kansas, accompanied by certified check in the sum of one thousand ($1,000.00) dollars on tract Number 1 (as advertised), being the west half of southwest quarter (W. ½ of SW. ¼) and southeast quarter of southwest quarter (SE. ¼ of SW. ¼) of section 16, township 21 north, range 7 east, Indian meridian, Pawnee County, Oklahoma, bonus being a hundred and twenty dollars ($120.00) or one dollar ($1.00) per acre.

Whereupon it was moved by Mr. Wilson and seconded by Mr. Carter, that the bid of above named companies be accepted and the secretary is hereby directed to grant a renewal of lease to each of said bidders, the lease to be dated from the expiration of old lease.

All vote aye: Motion prevailed.

95 Thereupon the witness Durant testified, as secretary of the commissioners of the land office, and as custodian of the records, that he was in possession of the lease which was executed by the commissioners of the land office pursuant to the foregoing resolution and said lease was produced, identified, offered, and introduced in evidence by petitioner and is as follows:

Offer in evidence

THE STATE OF OKLAHOMA:

Oil and gas mining lease

T-2. 3-18-19

This indenture of lease, made and entered into in duplicate on this the 18th day of March, A. D. 1919, by and between the commissioners of the land office of the State of Oklahoma, acting for and in behalf of the State of Oklahoma, parties of the first part, hereinafter designated as lessor, and Coronado Oil and Gas Company, Cleveland, Oklahoma, party of the second part, hereinafter designated as lessee, under and in pursuance of the provisions of the constitution and laws of the State of Oklahoma, relating to the segregation of the oil and gas deposits and the leasing thereof on school and other public lands belonging to the State of Oklahoma, witnesseth:

I, the lessor, for and in consideration of four hundred & eighty no/100—($480.00) dollars, the receipt whereof is hereby acknowledged, and of the royalties, covenants, stipulations, and conditions hereinafter contained and hereby agreed to be paid, observed, and performed by the lessee and his lawful assigns, does hereby demise, grant, lease, and let unto the lessee for the term of five years from the date hereof, and as long thereafter as oil or gas or either of them

is produced in paying quantities, all the oil deposits and natural gas in or under the following described tract of land lying and being within the county of Pawnee, in the State of Oklahoma, to-wit:

Northeast (NE. ¼) quarter; south half of northwest (NW. ¼) quarter, south half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) of section (16), township twenty-one (21)
96 north range 8 east, I. M., and containing 480 acres, more or less, with the exclusive right to prospect for, extract, pipe, store, and remove oil and natural gas, and to occupy and use only of the surface of said land as may reasonably be necessary to carry on the work of prospecting for, extracting, piping, storing, and removing such oil and natural gas. Also the right to obtain from wells or other sources on said land by means of pipe lines or otherwise, a sufficient supply of water to carry on said operations except the private wells or ponds of the surface owner or lessee, and also the right to use, free of cost, oil and natural gas as fuel so far as necessary to the development and operation of said property.

2. The lessee hereby agrees to deliver or cause to be delivered to the commissioners of the land office of the State of Oklahoma, or their successors, a royalty, of one-eighth part of the oil or gas produced from the leased premises or in lieu thereof pay to the State the market value of said royalty interest, as the commissioners may elect. All oil and gas due to the State under this contract, shall be delivered by the lessee herein, free of cost, into pipe lines, tanks, or cars, or settled or paid for before removing same from the premises if handled in any other way. The lessee shall furnish to the lessor certified copies of gauge tickets, sales, shipments, and amount of gross production at their office in Oklahoma City. Gas to be metered on the premises under high pressure, unless some other method of gauging and metering same shall be hereafter agreed upon by the parties hereto in writing.

3. The lessee shall exercise diligence in sinking wells for oil and natural gas on the land covered by the lease, and shall drill a sufficient number of wells to offset the wells upon adjoining contiguous premises, said offset wells to be commenced within ten days after completion of any producing well upon such adjoining contiguous premises, unless a different time is prescribed by notice in writing from the lessor, and be prosecuted diligently and continuously until completed; and the said lessee shall operate the leased premises for oil and gas to same extent as individual and corporate
97 premises are being operated within the general oil and gas fields where such land is located, and failure to faithfully comply with this provision shall be cause for forfeiture of this lease to the State.

At least one well producing oil or gas in paying quantities shall be drilled and completed within one year from the date hereof, or failing so to do the lessee shall pay to the lessor for each whole year the completion of such well is delayed, for not to exceed five years from the date hereof, in addition to the other consideration named

herein, a rental of one ($1.00) dollar per acre, payable annually, in advance, and if the lessee shall fail to drill at least one such well within such yearly period, and shall fail to surrender this lease on or before the end of any such year during which the completion of such well is delayed, such failure shall be taken as conclusively evidencing the election and covenant of the lessee to pay the rental of one ($1.00) dollar per acre for such year, and thereupon the lessee shall be absolutely obligated to pay such rental. The failure of the lessee to pay such rental before the expiration of fifteen (15) days after it becomes due at the end of any yearly period during which a well has not been completed, as herein provided, shall be a violation of one of the material and substantial terms and conditions of this lease and be cause for cancellation thereof, but such cancellation shall not in any wise operate to release or relieve the lessee from the covenants and obligations to pay such rental or any other accrued obligation. It being understood that the completion of one well, producing oil or gas in paying quantities during the life of this lease, shall relieve the lessee of all future liability for said $1.00 per acre hereunder, but the lessee shall, nevertheless, remain obligated to drill an offset, or necessary offsets, and other wells necessary to the proper development and operation of said lease as herein otherwise provided; and provided further that unless a producing well of oil or gas is completed on the above-described premises within five years from the date hereof this lease shall be void.

4. The lessee shall carry on the development and operation in a workmanlike manner; commit no waste on said land, and suf-
98 fer none to be committed upon the portion in his occupancy or use; take good care of the same, and promptly surrender and return the premises upon the termination of this lease to the lessor, or to whomsoever shall be lawfully entitled thereto, unavoidable casualty only excepted.

All tools, derricks, boilers, boiler houses, pipe lines, pumping and drilling outfits, tanks, engines, and machinery, and the casing of all dry or exhausted wells, shall remain the property of the lessee and may be removed at any time prior to or at the termination of the lease by forfeiture or otherwise; and the lessee shall not permit any nuisance to be maintained on the premises; and shall not use said premises for any purposes than those authorized in the lease; and before abandoning any well, shall securely plug the same so as to effectually shut off all water from the oil-bearing stratum, or in the manner required by the laws of the State of Oklahoma.

5. The lessee shall keep an accurate account of all oil and gas mining operations, including a log of each well drilled, duly sworn to by the contractor or driller, which shall be filed with the secretary to the commissioners of the land office within thirty days after said well is completed. Accurate and reliable information concerning all wells and their operation and management shall be furnished to the commissioners of the land office or their representatives upon demand. The said lessee shall also keep an accurate account show-

ing the sales, prices, dates, purchases, and the whole amount of oil and gas mined or removed, and all sums due as royalties shall be a lien on the implements, tools, and movable machinery or personal chattels used in operating said property, and also upon all the unsold oil and gas obtained from the land herein leased as security for the payment of said royalties.

6. The lessee shall be liable to the surface owner or surface lessee for all damages or loss accruing to the surface interests in said land, and to all crops and improvements thereupon and appurtenances and hereditaments thereunto belonging by reason of the oil or gas mining operations hereunder, and in the event the amount of such damage cannot be agreed upon by the lessee hereof and such surface owner or lessee, then the amount of such damage shall be determined as is or may be provided by law. The lessee hereof further agrees to pay all such damages within ten days after the amount thereof is determined and the amount of such damages may be recovered from the lessee hereof and his sureties upon the bond given to secure the faithful performance of this lease.

99

7. This lease shall be subject to the constitution and laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office now or hereafter in force relative to such leases; all of which are made a part of condition of this lease; provided, that no regulations made after the execution of this lease affecting either the length of the term hereof, the rate of royalty, or payment hereunder or the assignment hereof, shall operate to affect the terms and conditions of this lease.

8. No transfer or assignment of this lease or any part thereof, shall be valid, or convey any right in the assignee without the consent in writing of the commissioners of the land office; and such assignee shall furnish a bond to the satisfaction of the commissioners of the land office, conditioned for the faithful performance of the covenants and conditions of this lease, and pay an assignment fee of five dollars.

9. Before this lease shall be in force and effect the lessee shall give a good and sufficient bond in the sum of two thousand & no/100 ($2,000.00) dollars, to be approved by the commissioners of the land office, for the faithful performance of this lease.

10. Upon the violation of any of the substantial terms or conditions of this lease, the commissioners of the land office shall have the right at any time after hearing upon ten days notice, given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the said premises, specifying the terms or conditions violated, to declare this lease, null and void; and the said commissioners for and on behalf of the State of Oklahoma, shall be entitled to recover from the lessee's bondsmen, all rents, royalties, charges, claims of every kind and nature due and owing and accruing and arising out of and by

reason of this lease, on failure to comply with the provisions
100 thereof, and the lessors shall be entitled and authorized to take immediate possession of the land.

11. It is further agreed that for any refinery of crude oil and its products and byproducts, owned and controlled by the State of Oklahoma, the State shall have the preference right to purchase and receive the output from said premises at the market price thereof; provided, that this clause shall not prevent the lessee from selling the output of said leases to any person, firm or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas or either of them under this proviso shall be valid and binding.

12. The lessee may at any time hereafter surrender and wholly terminate this lease upon payment of the rentals and other liabilities then accrued and due hereunder, and may exercise such right by filing a formal relinquishment and release of the said lease with the secretary to the commissioners of the land office; provided, that if such lease has been recorded, by causing the release thereof to be filed and recorded in the proper recording office, and upon a compliance with these requirements such lessee shall thereby be relieved from liability for rental thereafter accruing.

13. The surface owner or lessee of the said premises shall have gas free of cost from any well on said premises for domestic use thereon by making his own connection with the well.

In witness whereof the parties hereunto subscribed their signatures on the day and year first above written.

THE COMMISSIONERS OF THE LAND
OFFICE OF THE STATE OF OKLAHOMA,

(S.) J. B. A. ROBERTSON,
Governor and Chairman.

Attest:

(S.) A. S. J. SHAW,
Secretary to the Commissioners of the Land Office.

CORONADO OIL & GAS COMPANY,
Lessee,

By R. L. LUNSFORD,
President.

Attest:

J. B. MYERS, *Treas.*

101 STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me, the undersigned notary public within and for said county and State, J. B. A. Robertson, to me known to be the person who subscribed the name of the commissioners of the land office of the State of Oklahoma to the foregoing instrument, as its chairman, and acknowledged to me that he executed the same as his free and voluntary act and deed, and as the free and

voluntary act and deed of such commissioners of the land office, for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and notarial seal on this 21st day of March, 1919.

My commission expires Aug. 18, 1920.

[SEAL.] LILLIAN A. DOWNS,
Notary Public.

Acknowledgement for corporation

STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me the undersigned notary public within and for said county and State, K. L. Lunsford, to me known to be the identical person who signed the name of the Coronado Oil and Gas Company to the above and foregoing instrument as its president, and acknowledged that he executed the same as his free and voluntary act and deed, and as the free and voluntary act and deed of the said corporation for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and notarial seal on this 21st day of March, 1919.

[SEAL.] LILLIAN C. DOWNS,
Notary Public.

My commission expires Aug. 18, 1920.

The witness Durant thereupon testified:

Under the rules and regulations of the school land department the lessee in an oil and gas lease of the character just introduced in evidence is required to give a bond. A bond was given by the lessee in connection with the lease just introduced in evidence and I have the bond.

102 Whereupon the bond referred to by witness was produced, identified, offered, and introduced in evidence, and reads as follows:

Offer in evidence

Oil and gas bond

STATE OF OKLAHOMA,
Pawnee County, ss:

Know by all these presents, that we, Coronado Oil and Gas Company, a corporation organized and existing under the laws of the State of Oklahoma as principal, and Southern Surety Company, a corporation organized and existing under the laws of the State of Iowa as surety, are held and firmly bound unto the State of Oklahoma in the sum of two thousand ($2,000.00) dollars, for the payment of which amount we hereby bind and obligate ourselves, successors, and assigns by these presents.

The conditions of the above obligations are such that if the above Bounden Coronado Oil & Gas Company, its successors and assigns, or either of them, do and shall well and truly in all things perform faithfully and keep each and all of the covenants, conditions, and agreements specified and contained in a certain oil and gas lease made and executed on the 17th day of January, A. D. 1919, and expiring on the 17th day of January, A. D. 1924, by and between Coronado Oil and Gas Company and the commissioners of the land office, of the State of Oklahoma for and on behalf of the State, covering the following land to wit: Within the county of Pawnee, Oklahoma: Northeast (NE. ¼) quarter; south half of northwest (NW. ¼) quarter; south half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) quarter and the southwest (SW. ¼) quarter of section sixteen (16), township twenty-one (21) north, range eight (8) E., I. M.; containing 480 acres, and which said lease is on file in the office of the secretary of the commissioners of the land office of the State of Oklahoma and is hereby referred to and made a part hereof, which on the part of the said Coronado Oil & Gas Company ought to be performed, fulfilled, and kept according to the true meaning and intent of the same, then the above obligation is to be void, otherwise to remain in full force and effect.

103 In witness whereof we have hereunto set our hands this 21st day of March, A. D. 1919.

CORONADO OIL & GAS COMPANY,
Principal,

By R. L. LUNSFORD,
President.

Attest:

J. B. MYERS, *Treas.*

SOUTHERN SURETY COMPANY,
Surety.

By L. N. BEADLES,
Attorney-in-Fact.

Attest:

_____,
Secretary.

Approved.

J. B. A. ROBERTSON.

Thereupon said witness further testified:

The school land covered by the above lease from the school land commissioners to the Coronado Oil and Gas Company, introduced in evidence, has never been sold by the State and the lease upon it is still in force.

Thereupon the witness Durant identifies minutes of the meeting of the commissioners of the land office of March 18, 1919, and the same are offered and introduced in evidence by the petitioner, as follows, to wit:

Offers in evidence

Re oil & gas: In the matter of the lease awarded to the Colorado Oil & Gas Company, of Cleveland, Oklahoma, covering the south half of the northwest quarter (S. ½ of NW. ¼); southwest *southwest* quarter of northeast quarter (SW. ¼ NE. ¼), and south half of southeast quarter (S. ½ of SE. ¼), section 16, township 21 north, range 8 east, Indian meridian; it was moved by Mr. Wilson and seconded by Mr. Carter that Mr. Durant, special agent oil & gas division, go over above land and take up the matter with reference to drilling an offset on above lease, and report to the board whether or not another well should be drilled.

All vote aye: Motion prevailed.

104 The same witness thereupon identified a record of the minutes of meetings of the commissioners of the land office from October 15, 1915, to March 16, 1916, and testified that there are five members of the commissioners of the land office, and identified the minutes of a meeting of the commissioners of the land office held on February 24, 1916, a portion of which was introduced and read in evidence by the witness as follows, to wit:

"Whereas, under oil and gas leases granted prior to December 3rd, 1915, and in certain lease contracts entered into between the commissioners of the land office and oil and gas leases on forms other than Form-1-Atty. Genl.-1915, no specific provision is made for appraising the costs of drilling producing wells; and whereas, the omission of such specific provision hinders the development of the lands so leased for oil and gas purposes up to the date of the expiration thereof; and whereas, it is to the best interests of the State that the fullest possible development of the said lands be had throughout the life of such lease:

"Be it resolved by the commissioners of the land office that the following rule and regulation be and the same is hereby promulgated:

"If oil or gas is being produced in paying quantities from any premises heretofore leased, three months before the expiration of the term of said lease, the property of the lessee hereinafter mentioned shall be appraised and the said premises shall be advertised for release for another term of five years to commence at the expiration of the said existing lease. If at any time within three months of the expiration of any existing oil and gas lease, but more than sixty days prior thereto, either party to the said lease shall so request the other in writing, then the casings, derricks, boilers, power houses, power plants, tanks, lines, tubing, rods, pumping, and drilling outfits, engines, and machinery, tools and all other appliances, and equipment used and reasonably required in the development and operation of the leased premises shall be appraised at the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office and one by the lessee or his lawful

assigns. The two appraisers so appointed shall before
105 making the appraisement appoint a third person and the appraisement of the majority of said three appraisers shall be binding upon the parties to said lease, and the said appraisers, in addition to the fair cash value of the property aforesaid, shall allow to the lessee or his assigns a fair, just and reasonable compensation for the cost and expense of drilling each well then producing oil or gas in paying quantities and of each uncompleted well, but no compensation shall in any event be allowed for any dry or abandoned well or completed well or the equipment thereof not then producing oil or gas in paying quantities. In advertising said land for release for a subsequent term of five years, the appraised value of said property of the lessee and of the improvements aforesaid shall be stated in said advertisement and any bidder other than the lessee herein named or his assigns shall be required, in addition to the cash bonus bid, to deposit a sum of money or certified check payable to the lessee, or his assigns, equal to said appraised value, with the commissioners of the land office.

"The lessee or his lawful assigns shall have three days, or such further time as the commissioners of the land office may grant, after the bids for a new lease are opened and the highest bidder determined by the said commissioners, in which to exercise his preference right to re-lease said premises. If the lessee or his assigns shall fail and neglect in such time to exercise such preference right and to enter into a good and sufficient contract and give such bond as may be required for such lease for an additional period of five years, then the commissioners of the land office may award the lease to such successful bidder and shall deliver the money or certified check as deposited to the lessee hereunder or his lawful assigns, and such successful bidder shall thereupon become the owner of all such casings, derricks, boilers, power houses, power plants, tanks, lines, tubing, rods, pumping and drilling outfits, engines and machinery and tools, and all other appliances and equipment, and as against the lessee and his assigns, shall be entitled to the immediate possession of the same and of said premises, and of the oil and gas thereafter produced therefrom.

"Resolved, further, that this rule and regulation shall have all
the binding force and effect of an agreement entered into
106 between the commissioners and any lessee under any lease
contract executed upon any form other than said Form 1-Atty. Genl.-1915, upon the acceptance of the same by such lessee or his assigns, such acceptance to be in writing and filed with the secretary of this board within sixty days from the date of the adoption hereof or such further time as the board may by resolution grant."

Thereafter the same witness identifies a supplemental agreement entered into between the Coronado Oil and Gas Company and the commissioners of the land office on the 17th day of January, 1917, which was offered and introduced in evidence by the petitioner and is as follows:

Offer in evidence

Supplemental agreement

STATE OF OKLAHOMA,
County of Oklahoma, ss:

Whereas, heretofore on, to wit: the 17th day of January, A. D. 1914, the commissioners of the land office of the State of Oklahoma, made and entered into a certain oil and gas mining lease to the Coronado Oil and Gas Company, of Cleveland, Oklahoma, covering the following described real estate and premises situated in the county of Pawnee, State of Oklahoma, to wit:

"The south half of the northwest quarter, the northwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one north (21 N.), range eight (8) east," which said lease was for a term of five years and provided for a royalty of 50 per cent of all oil and gas produced and sold from the fifteen wells then in operation upon said premises, and

Whereas, the said lease contract did not provide for the drilling of additional wells, and

Whereas, owing to the small production in that locality by reason of the territory being heavily drained by adjacent wells by reason of long operation and by reason of such conditions the commissioners of the land office at a meeting held December 6, 1916, adopted and approved the following recommendation:

"With reference to the application of Coronada Oil and Gas Company, of Cleveland, Oklahoma, who hold oil and gas lease
107 on portions of section 16, township 21 N., range 8 east, Pawnee County, Oklahoma, to drill additional wells on this lease at a reduced royalty of 12½ per cent. I am herewith submitting the following recommendation: That they be allowed to drill additional wells at a royalty of 12½ per cent for the reason that there are locations on this lease that ought to be drilled as our school section is now being heavily drained by wells on adjoining lands which are located along the lines of our school section and are as near to the section lines as they can be drilled. A portion of the derricks of the wells on the adjoining lands are setting in the road and the wells are right up against the section line. The wells on the school section are back from the line about 500 feet and room for a diagonal location between the wells on the school section and the wells on the adjoining lands. The Coronado Oil & Gas Company can not afford to drill additional wells at a royalty of 50 per cent, therefore, I believe the royalty on the new wells drilled should be reduced to 12½ per cent as there is no possibility of getting any big wells for the reason that the lands have been heavily drained. I further recommend that the locations for these new wells be made by this department so that they will not interfere with the wells which are not producing and on which the State is now getting 50 per cent

royalty, and also that they be located so that they will more effectually offset wells on adjoining premises.

"It was moved by Mr. Wilson and seconded by Mr. Gault that the recommendation of the special agent be, and the same is hereby, ordered approved, that the said Coronado Oil and Gas Company be allowed to drill additional wells at a royalty of 12½ per cent, provided however, that said location shall be made by this department, and the special agent, T. J. Ellis, jr., is hereby authorized and directed to locate all said additional wells for this department; it being understood that this order allowing additional wells to be drilled at a 12½ per cent royalty in no wise affects the royalty upon the wells already drilled and producing.

"All vote aye; motion prevailed."

Now, therefore, in consideration of the above stipulations the parties hereto agree to the conditions therein contained and set out.

108 In witness whereof the parties hereunto subscribe their signatures the day and year first above written.

COMMISSIONERS OF THE LAND OFFICE
OF THE STATE OF OKLAHOMA,
By R. L. WILLIAMS,
Governor and Chairman.

Attest:
[SEAL.]
F. A. SMITH,
Secretary to Commissioners.

CORONADO OIL & GAS COMPANY,
By G. W. SUTTON,
President.

Attest:
[SEAL.]
GEO. W. REYNOLDS,
Secretary Coronado Oil & Gas Company.

The witness Durant then testified:

I was born in the territory now comprised in the State of Oklahoma and have lived in the State sixty-one (61) years. I am familiar with the tracts of land about which I have been testifying. They are situated in Pawnee County in what formerly constituted Oklahoma Territory and have been in possession of the commissioners of the land office through its lessees and have been regulated and supervised by the commissioners of the land office since the beginning of the State.

On cross-examination the witness Durant further testified:

It is the custom of the land office with respect to the execution of leases never to execute and deliver a lease until the bond is filed by the lessee and approved.

On redirect examination the witness further testified:

In case leases are assigned the assignee is required to give a bond. It is an ordinary occurrence for a lease to be awarded to a bidder and upon the direction of the successful bidder the lease is executed

to some one else. In that event the bond is executed by the person who executes the lease.

109 Thereupon certain sections and part of sections and provisions of the enabling act adopted by Congress and approved by the President on June 16, 1906, chapter 3335, United States Statutes of 1905 and 1906, part 1, page 267, were offered, introduced, and read in evidence by the petitioner as follows:

Offers in evidence

"SECTION 7. That upon the admission of the State into the Union, sections numbered 16 and 36, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: *Provided*, That sections 16 and 36 embraced in permanent reservations for national purposes shall not at any time be subject to the grant nor the indemnity provisions of this act, nor shall any lands in Indian, military, or other reservations of any character, nor shall land owned by Indian tribes or indiyidual members of any tribe be subjected to the indemnity provisions of this act until the reservations shall have been extinguished and such lands be restored to and become a part of the public domain: *Provided*, That there is sufficient untaken public land within said State to cover this grant: *And provided*, That in case any of the lands herein granted to the State of Oklahoma have heretofore been confirmed to the Territory of Oklahoma for the purposes specified in this act, the amount so confirmed shall be deducted from the quantity specified in this act.

"SECTION 8. * * * Where any part of the lands granted by this act to the State of Oklahoma are valuable for minerals, which term shall also include gas and oil, such lands shall not be sold by the said State prior to January 1, 1915; but the same may be leased for periods not exceeding five years, by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid to the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be cov-
110 ered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right to the assignee without the consent of the proper State authorities in writing: *Provided, however*, That agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of said mining operations. The legislature of the State may prescribe additional legislation governing such leases not in conflict herewith."

Thereupon was offered, introduced, and read in evidence by the petitioner the ordinance irrevocably adopted by the constitutional convention of the State of Oklahoma in 1907, accepting the enabling act, which is as follows:

Offer in evidence

"Be it ordained by the constitutional convention for the proposed State of Oklahoma, that said constitutional convention do, by this ordinance, irrevocably, accept the terms and conditions of an act of the Congress of the United States entitled 'An act enabling the people of Oklahoma and the Indian Territory to form a constitution and State government and be admitted into the Union on an equal footing with the original States; and to enable the people of New Mexico and of Arizona to form a constitution and State government and be admitted into the Union on an equal footing with the original States,' approved June the 16th, A. D. 1906."

Thereupon is offered, introduced, and read in evidence by petitioner section 1, article 11, of the constitution of the State of Oklahoma (erroneously described in transcript as article 3), as follows:

Offer in evidence

"The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the enabling act and any other acts of Congress for the uses and purposes and on the conditions for which same are granted or donated, and the State also hereby pledges itself to preserve such lands or moneys and all moneys derived from the sale of said lands as a sacred trust to keep same for the use and purposes for which they were granted or donated."

111 Thereupon is offered, introduced, and read in evidence by petitioner an act entitled:

Offer in evidence

"An act to authorize the commissioner of the land office to lease public lands for oil and gas purposes," approved by the Governor of the State of Oklahoma, May 26, 1908, and to be found at page 490 of the Session Laws of Oklahoma, 1907–08, which is as follows:

Be it enacted by the people of the State of Oklahoma:

SECTION 1. When any tract of the school and other public lands, granted to the State of Oklahoma under the act of Congress known as the "enabling act" is, by the commissioners of the land office of the State, known to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office, their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall

conclusively withhold the same from sale, lease or other alienation, except as provided in this act.

SECTION 2. Each agricultural, timber, grazing, or other lease to any surface interest in the deposits segregated, as provided in section one hereof, and further reserve to the State and its lessees and grantees the right to drill and operate for oil and gas wells on such premises, and the easement use and right of way to enter upon and fully enjoy the mining right reserved in this act.

SECTION 3. The oil and gas interest described in this act in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five (5) years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

112 Second. Upon due advertisement and public notice of not less than thirty days, in such manner as such commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder; provided, the commissioners of the land office shall have power to reject any and all bids.

SECTION 4. The lease contract of the State, with any lessee for oil and gas purposes, shall stipulate, and the advertisement for bids for leasing such land shall specify a fixed royalty, to be determined by the commissioners of the land office, and in no event less than 12½ per centum of the total output of such oil and gas, and in addition thereto any bonus offered for such lease, and shall also require a deposit of sufficient earnest money in the hands of such commission as such commission may require to accompany each bid, with appropriate conditions of forfeiture for failure to comply with the terms and conditions of bidding upon such lands. All leases for oil and gas provided in this act shall contain a provision requiring the lessee to drill a sufficient number of wells upon the leased premises to offset the wells upon adjoining contiguous premises, and a further provision that a failure to faithfully operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such land is located, shall forfeit such lease to the State. No transfer of assignment of any lease shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office. The board of land office commissioners shall require a good and sufficient bond for the faithful performance of said lease and may make such additional rules and regulations covering same as are not specifically provided for in this act.

SECTION 5. No lease shall be executed to, or in the interest of any pipe line or transportation company, or any company allied to, or

confederated therewith, or any subsidiary company thereof, nor any other company, corporation, person, or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative or employee, acting singly or as firms or corporations of such company, or either of them. Leases executed under
113 the terms of this act shall stipulate that, for any refinery of crude oils or its products and by-products, owned, operated, or controlled by the State, the State shall have the preference right to purchase and receive the output of such oil and gas lease at the market price thereof; provided, nothing in this act shall prevent the lessee from selling the output of said leases to any person, firm, or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas, or either of them, and all sales of oil and gas under this proviso shall be valid and binding.

SECTION 6. Any person, firm, or corporation leasing under the provisions of this act and operating for oil and gas, shall be liable to the surface owner, the lessee or purchaser, for all damages or loss accruing to the surface interest in said land and to all crops and improvements thereunto belonging, whether said land be agricultural, timber, grazing, or otherwise.

SECTION 7. Should the lessee or owners of the surface interest and the lessee of the oil and gas interest specified in this act be unable to agree upon the damage and loss sustained by such surface lessee or owner by such lessee of the oil and gas interest therein, may condemn the same for such purpose under the law of eminent domain to like extent and in the same manner and upon the same procedure and remedies as is provided for the assessment or damages and compensation to the owner of the fee in case of condemnation for railway purposes.

SECTION 8. The commissioners of the land office shall have plenary power and authority to enter their finding of record in their office, modifying, altering or vacating any order, finding or entry, and when any tract or parcel of land shall be proven to be valueless for oil and gas purposes, or such tract of land or the oil and gas fields in which the same is situated shall become impoverished and exhausted, then such commissioners shall enter of record their finding of such non-oil and gas bearing character, or such exhausted or valueless condition for such oil and gas purposes, and when so entered of record by such commissioners, the oil and gas character of such land shall conclusively terminate. Upon premises
114 leased for oil and gas purposes, no finding or other entry of record shall be made, modifying, altering, or vacating any order, finding, or entry, previously made until notice of not less than ten days shall be given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the premises vacated by such new finding, order or entry.

SECTION 9. The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this act provided, shall be carried into the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions and under the limitations for which the same were granted and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

SECTION 10. All acts and parts of acts, rules, and regulations as well as the alterable provisions of the schedule of the Constitution of the State, in conflict herewith, are modified, amended, and repealed to conform hereto.

SECTION 11. An emergency is hereby declared, by reason whereof it is necessary, for the immediate preservation of the public peace and safety that this act take effect from and after its passage and approval.

Approved May 26, 1908.

Thereupon is offered, introduced, and read in evidence by petitioner an act adopted by the Legislature of the State of Oklahoma, entitled "An act regulating the leasing of school and other public lands owned by the State for oil and gas purposes, and declaring an emergency," which is as follows:

Offer in evidence

SECTION 1. The commissioners of the land office are authorized to lease for oil and gas purposes any of the school or other lands owned by the State of Oklahoma, which such commissioners may deem valuable for oil and gas, for the term of five years and as long
115 thereafter as oil or gas may be produced therefrom in paying quantities, upon such terms and conditions and in such quantities as the commissioners shall by rules and regulations prescribe. Each such lease shall provide for the delivery to the State of a royalty of not less than one-eighth part of the oil or gas produced from the leased premises or in lieu thereof the payment to the State of the market value of said royalty interest, as the commissioners may elect. Such leasing shall be made by public competition after not less than thirty days' notice by publication in two newspapers authorized by law to publish legal notices, one of which newspaper shall be published at the State Capitol, and the other in the county where the land is situated, such leasing shall be let by sealed bids and each lease awarded to the highest responsible bidder. Such oil and gas leases may be assigned only with the consent and approval of the commissioners of the land office. Provided, that the commissioners have the right to reject any and all bids.

Empowered to segregate

SECTION 2. The commissioners are empowered to segregate any of the school or public lands for mineral purposes which the commissioners may, by order entered of record, determine to be valuable for oil, gas, or mineral purposes, and each agricultural, grazing, or other lease of the surface rights or interest in any land so segregated shall reserve to the State, its lessees, or grantees, the right to explore, drill, and operate for oil or gas on such lands, as well as the right to enter upon the said lands and enjoy the mining rights so reserved.

Term of lease

SECTION 3. All oil and gas leases executed by the commissioners of the land office shall be for a term of five years, and as long thereafter as oil or gas may be produced in paying quantities; provided, upon the forfeiture, or cancellation of surrender, or expiration of lease by reason of its termination on account of the five years' limit, provided for in the "enabling act," or any other cause, the school land commissioners shall provide for the leasing of such land in the same
116 way and in the same manner that the school land commissioners lease land which has never been leased. Provided, on such leases which are surrendered or which may expire or which have expired, the lessees or assigns shall have the value physical properties on such lease, which value shall be determined by a board of appraisers especially appointed by the school land commissioners for the appraising of physical property of leases. Provided, no physical property valuation shall be attached or considered in the making of a lease on a tract consisting of more than 640 acres. If no well shall be completed upon any leased premises within one year from the date of the lease, the lessee shall pay to the State of Oklahoma an annual rental in advance of such sum per acre as the commissioners shall prescribe in the lease, which payment shall operate to defer the completion of a well during the year for which such rental payment is made.

Provision of lease

SECTION 4. All leases for oil and gas shall contain a provision to drill one well on each leased tract within one year from the date of such lease or, on failure to complete such well, to pay an annual rental per acre as hereinbefore provided. All such leases shall further provide that the lessee shall drill a sufficient number of wells upon the leased lands, to offset all producing wells upon any adjoining or contiguous lands, and a further provision that the failure of the lessee to diligently and in good faith operate the leased premises for oil and gas to as full an extent as other lands are operated in the general oil and gas field where such leased lands is

located, shall forfeit all rights of the lessee under such lease. Each lessee shall execute a bond to the State of Oklahoma, with sureties to the approval of the commissioners, and in such sum as the commissioners shall prescribe, conditioned for the faithful performance of the provisions of the lease and for the payment of all recoverable damages which such lessee may cause to the property, crops, or rights of the surface lessee.

Each lease shall further provide that in the event the State shall at any time operate a refinery for the refining of crude petroleum, or the extraction of any of its products or by-products, the
117 State shall have the preference right to purchase and take the production or output of any such oil or gas well at the prevailing market price thereof, upon the commissioners serving written notice upon the owners of any well, of the purposes and readiness of the State to take such production.

Rules governing leases

SECTION 5. The commissioners of the land office may adopt and promulgate appropriate rules and regulations for carrying into effect the provisions of this act, but no restrictions or prohibitions against any bidder or prospective bidder shall be made other than as provided in this act.

Lessee liable—surface owners

SECTION 6. The lessee, under any oil or gas lease executed by the commissioners of the land office shall be liable to the surface owner or lessee for all injury, damage, or loss occurring to the surface interest, interest in such lands or to any building, crops or improvements, or other property, located upon or used in connection with said land.

Funds—bonuses—royalties

SECTION 7. All funds arising from bonuses, royalties, or rentals for oil and gas leases, shall be carried into and credited to the permanent funds for the use and purpose designated in the grant of such lands by Congress to the State of Oklahoma and all such funds shall be kept, handled, and used in like manner as other money belonging to said permanent funds.

Acts in conflict repealed

SECTION 8. All acts or parts of acts inconsistent herewith, are hereby repealed.

Emergency

SECTION 9. For the preservation of the public peace, health and safety, an emergency is hereby declared to exist, by reason whereof,

this act shall take effect and be in force from and after its passage and approval.

Approved this 30th day of March, 1917.

118 Thereupon the following colloquy between counsel, in open court, occurred:

Mr. HAYES. Now, I would like to have it understood and agreed, if the board pleases, that the act of 1907 and '08, the first act introduced in evidence, was in force at the time of the execution of the first lease and that the act of 1917, the second act introduced, was in force at the time of the execution of the second lease. Is that correct?

Mr. DWIGHT H. GREEN. Yes; that is correct.

Whereupon G. W. REYNOLDS, being duly sworn, testified on behalf of petitioner as follows:

"I have been Secretary of the Coronado Oil and Gas Company since it was organized in January, 1914. The company was organized to take over the school-land lease that had been bid in by Dr. Sutton and took it over immediately after the oragnization was perfected. The lease is on land 16–21–8. The Coronado Oil and Gas Company owned no other property in January, 1914, than the lease, and has owned and operated just that one lease on the school land. It had no source of income during the years 1917, '18, and '19 except the revenue from this lease. It was a developed oil and gas lease on which there were probably fifteen operating wells. The company derived its entire income during the years 1917, 1918, and '19 from the production and the sale of oil produced from the lands covered by this lease."

On cross-examination the witness Reynolds further testified:

"I was one of the incorporators of the Coronado Oil & Gas Company. As secretary of the company, I have with me the minute books of the company, which shows a copy of the articles of incorporation of the company, and which I am willing to put into evidence."

Whereupon there was introduced and read in evidence by the respondent the following from article 2 of the certificate of incorporation, which outlines the purpose of the petitioner corporation:

Offer in evidence

The purpose for which this corporation is formed are as follows:

119 To lease, hold, control, operate, and sub-lease oil, gas, coal, and other mineral lands; to prospect for oil and gas, coal, and other minerals and mine for the same; to conduct drilling and mining operations for, and to produce oil, gas, coal, and other minerals; to borrow money when necessary to advance such prospecting and operating, and to pledge, bond, and mortgage the interests of this corporation in and to such real estate, personal property, and chattels real as it may own, as security therefor; to buy, sell, convey, and give title to and for leases, and leasehold estates for oil, gas,

coal, and other mineral properties, and to own and hold said power plants, pumping stations, and plants for oil, gas, and water; to buy, sell, and trade, refine, work in, and utilize, refined and crude oil and its various products, gas, and coal and their products, and other minerals and their products and to do all things whatsoever that it might or could do under and by virtue of the laws of the State of Oklahoma, and such other State or States as it may in the future operate and forward and promote any and all other purposes herein set forth.

Thereupon the same witness further testified on cross-examination: There is no particular reference in the articles of incorporation to this particular leasehold that has been described and about which evidence has been introduced here. There is no particular reference in any article of the articles of incorporation referring to this particular leasehold or particular tract of land. I considered that the company had the power to procure leases and go into the oil business anywhere it could get them. As organizer of this company, I did not put any money into it. I did own some shares of stock in it at first, but do not now. I did not pay anything for those shares. One share was carried in my name, just enough to qualify me as director.

Thereupon counsel for both petitioner and respondent stated they had no further evidence to present and rested their case. The foregoing is the substance of all the evidence introduced at the trial of said proceeding.

120 Petitioner agrees that the amount of gross income and net income of petitioner for the years 1917, '18, and '19 as found by the Board of Tax Appeals, and the amounts of deficiency taxes for said years, respectively, as determined by the Board of Tax Appeals are correct, if it be determined that the income of petitioner, derived and received during said years from the production and sale of oil from said oil and gas leases is subject to income and profit taxes or renders petitioner liable under the law to the payment of income and profit taxes by reason of such income.

S. W. HAYES,
T. P. GORE,
Attorneys for Petitioner.

The foregoing statement of evidence is accepted as correct and it is agreed by the respondent that the same may be settled by the Board of Tax Appeals and made part of the record in the foregoing case.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue, Attorney for Respondent.

Order settling statement of evidence

The foregoing contains the substance of all the evidence given at the hearing of this proceeding. That the same may be preserved

and made a part of the record this statment of evidence is duly stated, approved, signed, and ordered to be made part of the record in the above entitled cause this fifth day of December, 1929.

By the board:

SUMNER L. TRUSSELL,
Member.

Now, December 9, 1929, the foregoing statement of evidence certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

121 Before United States Board of Tax Appeals

[Title omitted.]

Præcipe for the record

Filed Dec. 5, 1929

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days from the date of the filing of the petition for review in the above stated case, transmit to the clerk of the Court of Appeals of the District of Columbia, certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the above-entitled case.
2. Pleadings before the board.
3. Findings of fact, opinion and decision of the board.
4. Petition for review.
5. Stipulation made under and pursuant to the provision of section 1002 of the revenue act of 1926, agreeing that the decision and judgment in this case may be reviewed by the Court of Appeals of the District of Columbia.
6. Statement of the evidence as settled.
7. This præcipe for the record.
8. Notice of filing this præcipe and proof or acceptance of service thereof.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the Court of Appeals of the District of Columbia.

S. W. HAYES,
1112 Colcord Building,
Oklahoma City, Oklahoma;
T. P. GORE,
1040 Woodward Building,
Washington, D. C.,
Attorneys for Coronado Oil and Gas Company.

122 The foregoing præcipe is agreed to and no counter præcipe will be filed.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue,
Attorney for Respondent.

Before United States Board of Tax Appeals

[Title omitted.]

Notice of filing præcipe

Filed Dec. 5, 1929

To C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Washington, D. C.,
Attorney for the Respondent:

SIR: Please take notice that on the 5th day of December, 1929, we filed with the clerk of this board, a præcipe designating the portions of the record to be transmitted to the Court of Appeals of the District of Columbia on the appeal taken in the above case, a copy of which præcipe is hereto annexed and hereby served upon you.

Dated this 5th day of December, 1929, at Washington, D. C.

S. W. HAYES,
1112 Colcord Building,
Oklahoma City, Oklahoma;
T. P. GORE,
1040 Woodward Building,
Washington, D. C.,
Attorneys for Coronado Oil and Gas Company.

123 Service of the foregoing notice and copy of præcipe is hereby accepted, this 5th day of December, 1929.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue, Attorney for Respondent.

Now, December 9, 1929, the foregoing præcipe, notice of filing, and proof of service certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[File endorsement omitted.]

124 In Court of Appeals of the District of Columbia

CORONADO OIL & GAS CO., APPELLANT
v.
COMMISSIONER OF INTERNAL REVENUE } No. 5115

Order allowing substitution, Dec. 5, 1930

On consideration of the motion filed herein to permit the above-entitled cause to be continued and maintained against David Burnet, Commissioner of Internal Revenue, successor in office of Robert H. Lucas, retired,

It is ordered by the court that said motion be, and it is hereby, granted and the substitution allowed as prayed.

125 [Minute entries of argument, April 7 and 8, 1931 omitted in printing.]

127 In Court of Appeals of the District of Columbia

CORONADO OIL AND GAS COMPANY, APPELLANT
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE } No. 5115

Appeal from the Board of Tax Appeals

Argued April 7, 1931. Decided June 1, 1931

T. P. Gore of Washington, D. C., for appellant; G. A. Youngquist, J. L. Monarch, A. D. Sharpe, and C. M. Charest, all of Washington, D. C., for appellee.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, HITZ, and GRONER, *Associate Justices*

Opinion filed June 1, 1931

GRONER, *Associate Justice:* This is a petition to review a decision of the Board of Tax Appeals.

By act of Congress approved June 16, 1906 (34 Stat. 267), the people of the Territory of Oklahoma were authorized to form a constitution preliminary to admission to statehood. In section 3 of the act, Congress required as a condition of admission that "provisions shall be made (in the Constitution) for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control"; and, by section 7, Congress granted to the State, for the use and benefit of the common schools, the sections of land numbered 16 and 36 in every township in Oklahoma Territory, and provided (section 8) that all lands granted by the act valuable for minerals, gas, and

oil should not be sold by the State prior to January 1, 1915, but might be leased for periods not exceeding five years, the proceeds from the land so leased to be covered into the school fund. The constitution as adopted provided for the establishment of a public free-school system, and pledged the faith of the State to preserve such lands and moneys "as a sacred trust," and to keep the same for the uses and purposes for which they were granted or donated, and provision was made for an executive department, to be known as "Commissioners of Land Office," to which was given the management of the school lands and of the funds derived therefrom.

128 After admission to statehood, the legislature (Statutes of 1921, section 9415, et seq.) provided by law for the leasing of the lands containing oil and gas for a first term of five years with the right of renewal for a second term of five years at a fixed royalty to be determined by the commissioners of the land office, but in no event less than twelve and one-half per cent of the total output of such oil and gas. The conditions of the leases are prescribed by statute, and, when made, are subject to all lawful rules which the commissioners may adopt. The right of the lessee to assign is forbidden except with the written consent of the commissioners, and provision is made for a sufficient bond to secure faithful performance. The leases provide that the State under certain circumstances shall have the preference right to purchase and take the entire output of oil and gas produced at the then market value of the same.

Appellant is an Oklahoma corporation. Its entire income during 1917–18–19 was derived from its operations as a lessee of the State of Oklahoma under two oil and gas leases executed to it by the State upon portions of the public school lands of the State. Appellant agreed to pay a royalty of fifty per cent of the gross production of oil in consideration of the leasing of the land to it. The question which we have to decide is whether the income derived by appellant from the sale of its share of the oil and gas obtained from such leased lands is taxable as income under the Federal income statutes (revenue act of 1916, 39 Stat. 756; rev. act 1917, 40 Stat. 300; rev. act 1918, 40 Stat. 1057). These acts in terms include the character of income in question, but appellant insists that it is an agency or instrumentality of the State of Oklahoma for development and operation of its State school lands, and that, under the Constitution, the United States can not tax such agency or instrumentality.

Neither a State nor the United States can tax the property, governmental functions, agencies, or instrumentalities of the other, or the means by which they are exercised. "As the States can not tax the powers, the operations, or the property of the United

129 States * * *, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State." Pollock v. Trust Co., 157 U. S. 429, 584. But it frequently happens that cases arise in which the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both

to function with the minimum of interference each with the other"—Metcalf & Eddy v. Mitchell, 269 U. S. 514, 523—and hence the limitation, as applicable to both State and Nation, has been the subject of discussion in numerous cases in the Supreme Court, and that court has adjusted the general principle to the limitation in the differing facts of each case, though in many the line of separation is sometimes so faint as to be difficult to follow, or, as Mr. Justice Stone remarked in Metcalf & Eddy v. Mitchell (p. 528), "Experience has shown that there is no formula by which that line may be plotted with precision in advance." Nothing, however, appears in any opinion to which we have had access which would indicate any distinction between State taxation of Federal agencies and Federal taxation of State agencies, except that in South Carolina v. U. S., 199 U. S. 437, where the State was shown to have engaged in a private business, an excise tax was held valid, and presumably the profits or income of the business taxable, but the decision was placed on the ground that the thing in which the State was engaged was not governmental. In many of the cases in which tax laws were held invalid, the tax was sought to be applied to some governmental activity. Bank v. Supervisors, 7 Wall. 26; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; Owensboro National Bank v. Owensboro, 173 U. S. 664. In other cases taxes which imposed "incidental" burdens were regarded as not impinging the general principle of exemption. Home Ins. Co. v. New York, 134 U. S. 594. But in South Carolina v. U. S. (supra), it was held that, though the State received substantial profits which were devoted to public purposes, the business was taxable. Some more recent decisions of the Supreme Court have carried the doctrine of exemption farther than it was, by many, originally thought to extend. Thus sales of commodities to the Government by a retailer have been held not [illegible] subject to excise taxes—Panhandle Oil Co. v. Mississippi, 277 U. S. 218—as has also income from royalties from the use of patents. Long v. Rockwood, 277 U. S. 142. On the other hand, in Baltimore Shipbuilding Co. v. Baltimore, 195 U. S. 375, State taxation of profits derived by a private corporation engaged in work for the Government was held valid; and in Fidelity Co. v. Pennsylvania, 240 U. S. 319, 327 was held that contracts between private corporations and the United States do not render the corporation an essential governmental agency or confer freedom from State taxation. And so it is insisted here on behalf of the Commissioner that whatever exemption the State of Oklahoma may enjoy from Federal taxation of its oil lands, this exemption does not extend to appellant because, though the State may be engaged in the business of maintaining the schools and thus in performing a governmental duty (1st Dillon on Municipal Corporations (5th Ed.), Sec. 89, 4th ed., sec. 1669; Claybrook v. City, 26 Fed. [illegible] Kahn v. Thompson, 134 N. W. 738; Frost v. School, 41 N. E. [illegible] Hamlin v. Davison, 39 Atl. 342; Howard v. Sasuma, 109 Pac. [illegible] appellant is not, but, as a private corporation, is engaged in profit-

ing and selling oil and gas; that is to say, in a private business and not a governmental activity. And so it is insisted that the imposition of the tax does not interfere with or impose a burden upon the State—that it is not a tax upon the lands or upon the oil or the gas, or the proceeds of the same which the State is entitled to receive, but is confined solely to that portion of the value of the gas and oil produced which appellant as a private corporation is entitled to have and use for its own account. In this aspect it is said that the case is much like Metcalf & Eddy v. Mitchell, supra, in which it was held that where "the tax is imposed on the income of one who is neither an officer nor employee of Government and whose only relation to it is that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity"—the tax is valid; and there is much strength and force in this argument, and, if the question were not, as we think, foreclosed, we are inclined to think we might feel impelled to adopt the view; but, as we see it, the Supreme Court has laid down the rule in Gillespie v. Oklahoma, 257 U. S. 501, and
131 Jaybird Mining Co. v. Weir, 271 U. S. 609, by which we are controlled. In the Gillespie case, the State of Oklahoma sought to impose a tax upon the net income derived by the lessee from leases of restricted Indian lands. Admittedly the lessee was an instrumentality used by the United States in carrying out their duties to the Indians, and, therefore, it was insisted the income derived by the lessee was not subject to taxation by the State. The State court held that, since the tax was not levied upon the Indians' income or share of the proceeds, the private share of the lessee was taxable. The Supreme Court reversed the State court, and Mr. Justice Holmes, speaking for the court, and quoting in part from Indian Oil Co. v. Oklahoma, 240 U. S. 522, 530, said:

"'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' The step from this to the invalidity of the tax upon income from the leases is not long.

"In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is pro tanto void; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; 158 U. S. 601; a rule lately illustrated by Evans v. Gore, 253 U. S. 245; and applied in a case somewhat like the present by the Supreme Court of Hawaii. Oahu Ry. & Land Co. v. Pratt, 14 Hawaii, 196. Whether this property could be taxed in any other form or not, it can not be reached as profits or income from leases such as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards."

We are unable to observe any difference in fact, or to perceive any distinction in principle, between the Gillespie case and that under consideration. In both there were oil lands. In the one case they were held by the Federal Government for the benefit of the Indians; in the other by the State for the benefit of its school children—white and Indian. In each there was a lease on a royalty basis. In
182 each the lessee was a corporation or private person; and in each the tax imposed sought to reach alone its or his profits from the operation of the lease. It is obvious, therefore, that the only difference in the facts is that in the one case the person sought to be taxed was an instrumentality of the Federal Government, and in the other, of the State government. If the tax was invalid in the one, it seems to us it must be invalid in the other, for, as we have already seen, the two governments stand upon an equality in the right of exemption of their respective instrumentalities from taxation. Unless, therefore, there is a higher and different obligation on the Federal Government in the protection of the interests of the Indians than is on a State in the education of its youth, the principle as it applies to the one must, we think, apply equally to the other. There can be no doubt that the school lands held by the State of Oklahoma in trust for the education of the youth of that State are as immune from taxation by the Federal Government as the lands held by the Federal Government for the Indians are immune from State taxation. If, therefore, the lessee of restricted Indian lands is a governmental instrumentality, it seems to us necessarily to follow that the lessee of school lands of the State, under identical conditions, is a governmental instrumentality, and since, as the Supreme Court said in the Gillespie case, the principle that invalidates a tax upon the leases likewise invalidates a tax upon the profits of the lessee, it must follow, we think, that the income from the leases can not be taxed in the one case any more than in the other. But it was argued at the bar of this court that while the analogy of the two cases seems so nearly perfect, there is a difference growing out of the fact that the United States, being a government of restricted or granted powers, has no right to engage in private business, and therefore whatever it does is in pursuit of a governmental function, but that this is not also true of a State which is without restrictions upon its right to enter private business, and therefore, it is contended, when a State undertakes to exploit its mineral or oil lands and sell the product thereof, it enters business as much as the State of South Carolina did when it engaged in the liquor business, but we are
183 not convinced by this argument. While it may be true the United States has no right to transact private business, and while it may also be true that when it enters into competition with private business, as it has in the operations of the Shipping Board and the Housing Corporation, all its acts in connection therewith are of a governmental character, and while it may be equally true that

a State may engage in private business, the fact is that in the exploitation of oil lands, like those in this and the Gillespie case, both the State and Federal Governments are using property earmarked with a governmental purpose, in the pursuit of a duty enjoined upon each equally to create and preserve a fund in the one case for the Indians as wards of the Nation, and in the other for the school children as wards of the State. It is, we think, the purpose, rather than the thing, which controls, but if this is not correct, then the thing, i. e. the sale of the oil, is, in the case of the Federal Government, identically like that in the case of the State Government, and it can not be said that the one government can engage in what is ordinary designated commerce and insist that because of its restricted powers it is engaged in the performance of a governmental function, and deny to a State in the same circumstances the same character, or classify its identical activity, because of its less limited powers, in a different category.

Unless, therefore, there is something in group No. 1 Oil Corp. v. Collector Int. Rev., — U. S. — (April 13, 1931), which modifies or changes the principle pronounced in the Gillespie case, supra, or which limits the immunity, there declared, solely to Indian lands under administration by the Federal Government, we shall feel impelled to hold, as we indicated, that the Gillespie case controls this. The main facts in Group Oil case in relation to its background and machinery are essentially like the facts in the Gillespie case and the case now under consideration. There, as here, the dispute arose over Federal income taxes on profits derived by a private corporation from the sale of oil and gas produced under leases to it by a State (Texas). There, as here, immunity was claimed as an instrumentality of the State for the development of its public domain. There the land from which the oil was taken had been set apart for the benefit of the State university; here for the benefit of the
184 school children of the State under a constitutional provision adopted pursuant to mandate of Congress in the grant of statehood. There, as here, the grant to the corporation was designated a lease, and there, as here, the return to the State was measured by a percentage of the oil produced. The distinction or difference between the Group Oil case on the one hand and this case and the Gillespie case on the other, arises out of the fact that in Texas the constitution of that State, as interpreted by the highest court of the State "requires the legislature to dispose of university lands by sale only"—Theisen v. Robison, 117 Texas 489, 502—and accordingly it was held in that case that leases like the one in Group Oil Co. case were present sales to the lessees of the oil and gas in place without restriction and without retention of interest in the vendor or lessor; in other words, that, though denominated a lease, the transaction was in fact a sale of all the oil and gas in the particular land conveyed. And the Supreme Court in the Oil Group case,

adopting this construction of the Texas constitution as binding, held the tax valid solely on that ground. But the same thing is not true of this case, for here there not only was no sale, but a congressional prohibition—accepted by the State—against one, and instead there was a lease with an agreed division of profits in all respects like that in the Gillespie case where the tax was held invalid. And so we have to conclude, that, unless we are mistaken in thinking there is no difference in the immunity from taxation of income derived from tribal lands of Indians and immunity from taxation of income derived from school lands of a State, where the income in each case arises under the same conditions, the principle applied in the Gillespie case is applicable in this case, and the Board of Tax Appeals was wrong in holding otherwise, and its decision should be and is reversed, and the case remanded for further proceedings not inconsistent with this opinion. Reversed.

MARTIN, *Chief Justice*, dissents from the foregoing decision, upon grounds which are fully stated in the majority opinion of the Board of Tax Appeals, included in this record, and also reported in 14 B. T. A. 1214.

[File endorsement omitted.]

135 In Court of Appeals of the District of Columbia

CORONADO OIL AND GAS COMPANY, appellant
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE
No. 5115. April term, 1931

Judgment

June 1, 1931

Appeal from the Board of Tax Appeals. This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel. On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed, and that this cause be and the same is hereby remanded to the said Board of Tax Appeals for further proceedings not inconsistent with the opinion of this court.

Per Mr. JUSTICE GRONER.

Mr. Chief Justice MARTIN dissenting.

136 In Court of Appeals of the District of Columbia

[Title omitted.]

Designation of record

Filed August 5, 1931

The clerk will prepare a transcript of record in the above-entitled case, including the following:

1. Printed record.
2. Order substituting party appellee.
3. Note of argument.
4. Opinion.
5. Judgment.
6. This designation, and clerk's certificate.

CLAUDE R. BRANCH,
Acting Solicitor General,
Counsel for Appellee.

AUGUST 5, 1931.

[File indorsement omitted.]

137 [Clerk's certificate to foregoing transcript omitted in printing.]

138 Supreme Court of the United States

Order allowing certiorari

Filed October 26, 1931

The petition herein for a writ of certiorari to the Court of Appeals of the District of Columbia is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 36155. District of Columbia Court of Appeals. Term No. 341. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Coronado Oil and Gas Company. Petition for writ of certiorari and exhibit thereto. Filed September 1, 1931. File No. 36155.

U. S. GOVERNMENT PRINTING OFFICE: 1931